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No. _____

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In The

Supreme Court of the United States

October Term, 1990

Norwest Bank Duluth, N.A.,
Petitioner,

v.

Minnesota Commissioner of Revenue
and the State of Minnesota,
Respondents.

Cambridge State Bank, et al.,
Petitioners,

v.

Minnesota Commissioner of Revenue,
Respondent.

On Petition for Writ of Certiorari to the Minnesota Supreme Court

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PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The State of Minnesota imposed a bank excise tax on net income, including interest on obligations of the United States ("federal obligations") but excluding interest on certain state and local obligations ("state obligations"). The Minnesota Supreme Court held the tax to be unlawfully discriminatory under 31 U.S.C. § 742, but refused to order a refund of taxes paid by Petitioners on federal obligation interest despite their compliance with state refund procedures. The questions presented are:

1. Whether a state court can require as a condition to bringing an action under 31 U.S.C. § 742 that a taxpayer pay a judicially imposed tax on state obligation interest that is exempt under state statutory law, where the tax is not imposed on any person not bringing an action under 31 U.S.C. § 742.

2. Whether a state court can deny refunds of a state tax that unlawfully discriminated against federal obligations by retroactively revoking the exemptions for state obligations and imposing a tax on state obligation interest. If so, whether a state court may deny such refunds:

   a. When it does not order the tax to be collected; or

   b. When it cannot order the tax to be collected because of an eleven-year interval between the year of the exemption and the state court's decision.

3. Whether a state court can refuse to apply the nondiscrimination rule of 31 U.S.C. § 742 through the purported prospective-only application of this Court's decision in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983).

LIST OF PARTIES AND RULE 29.1 STATEMENT

The parties to the proceedings in the Minnesota Supreme Court were: (1) Petitioners Norwest Bank Duluth, N.A. ("Norwest"), Cambridge State Bank ("Cambridge"), First Security State Bank of Sleepy Eye ("First Security") and Midway National Bank of St. Paul ("Midway"), and (2) Respondents Arthur C. Roemer, Commissioner, Minnesota Department of Revenue, and the State of Minnesota. The current Minnesota Commissioner of Revenue is John P. James.

The following is a Rule 29.1 listing of parent companies of the Petitioners and subsidiaries of the Petitioners other than wholly-owned subsidiaries.

Norwest Bank Duluth, N.A.

Norwest Corporation

Cambridge State Bank

None

First Security State Bank of Sleepy Eye

First Sleepy Eye Bancorp

Midway National Bank of St. Paul

None

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On Petition for Writ of Certiorari To
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PETITION FOR WRIT OF CERTIORARI

The Petitioners respectfully ask that a writ of certiorari issue to review the judgment of the Minnesota Supreme Court entered in the above-entitled proceeding.

OPINIONS BELOW

The opinion of the Minnesota Supreme Court (Yetka, J.) is reported at 457 N.W.2d 716, and is reprinted in the appendix hereto at App. 1A. The Minnesota Supreme Court affirmed in part and reversed in part unreported decisions of the Ramsey County District Court (the Honorable Harold Schultz) rendered in bifurcated proceedings. The district court's decisions in Phases I and II of the trial are reprinted in the appendix hereto at App. 16A and App. 30A respectively.

JURISDICTION

The judgment of the Minnesota Supreme Court was entered on August 28, 1990, and is reprinted in the appendix hereto at App. 47A. Jurisdiction to review that judgment by writ of certiorari is conferred upon this Court by 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

During the 1979 tax year at issue, Rev. Stat. § 3701, then codified at 31 U.S.C. § 742, provided as follows:

> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either

> the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

This statute is now codified, with minor amendments not affecting a substantive change in the law, at 31 U.S.C. § 3124(a).

The United States Constitution, article I, § 8, cl. 2 (the "Borrowing Clause"), provides that Congress has power "[t]o borrow money on the credit of the United States."

The United States Constitution, article VI, cl. 2 (the "Supremacy Clause"), provides in relevant part:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

The United States Constitution, amendment XIV, § 1 (the "Due Process Clause"), provides in relevant part:

> . . . nor shall any State deprive any person of . . . property, without due process of law; . . .

The full text of the relevant Minnesota statutes is set forth in the appendix hereto at App. 48A-53A.

STATEMENT OF THE CASE

During 1979, Minnesota imposed an excise tax on banks measured by net income. Minn. Stat. § 290.361 (1978). Interest on

federal obligations was taxable while interest on certain state obligations was exempt. Petitioners, who were subject to the bank excise tax, paid tax on federal obligation interest for 1979. Thereafter, they timely filed claims for refund of taxes paid with respect to federal obligation interest. (App. 20A.) Petitioners asserted as a basis for their claims that the Minnesota bank excise tax was discriminatory in violation of 31 U.S.C. § 742 and the intergovernmental immunity doctrine. In support of their claims, they cited *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), which held a nearly identical Tennessee tax to be discriminatory against federal obligations and violative of 31 U.S.C. § 742 and the intergovernmental immunity doctrine. After the expiration of a six-month period during which the Minnesota Commissioner of Revenue (the "Commissioner") failed to act upon their claims, Petitioners timely filed refund actions in Ramsey County District Court against the Commissioner and the State of Minnesota.[1] (App. 20A.)

The parties stipulated in the trial court that in 1979 federal obligation interest was taxable while state obligation interest was exempt. Respondents took the position that the bank excise tax, despite its facial discrimination, was nonetheless lawful on the theory

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[1] Petitioners followed the procedures set forth in Minn. Stat. § 290.50 (1982 and Supp. 1983) (App. 50A) in filing claims for refund of taxes paid "in excess of the amount legally due" and filing refund actions in state district court. Petitioner Norwest filed suit for the 1979 year only. Petitioners Cambridge, First Security and Midway, together with approximately 200 other banks, filed suit for the years 1979 through 1983 in a separate action, which was consolidated with the Norwest suit by the district court. By agreement of counsel and order of the district court, Petitioners Cambridge, First Security and Midway were selected as "test banks" from among the numerous plaintiffs in the case, and 1979 was selected as the "test year." Judgment was entered as to the test banks for the 1979 test year in accordance with Minnesota Rules of Civil Procedure, Rule 54.02, which permits final judgment with respect to fewer than all of the claims or parties when there is no just reason for delay. In briefs filed below, the Commissioner has asserted that approximately 700 banks in Minnesota have claims similar to those here at issue.

that harm to the Federal Government was only *de minimis*. The trial court determined on the basis of expert economic testimony that there would be an annual increase in federal borrowing costs of $1.75 billion if all states adopted discriminatory bank excise taxes similar to the Minnesota tax. (App. 25A.) The court concluded that this impact was "far from *de minimis*," (App. 26A), and held that the bank excise tax unlawfully discriminated against federal obligations in violation of 31 U.S.C. § 742 and the United States Constitution. (App. 21A.) This holding and the rejection of the *de minimis* argument were affirmed on appeal by the Minnesota Supreme Court. (App. 6A-8A.)

While both the trial court and the Minnesota Supreme Court agreed that the bank excise tax discriminated against federal obligations, they disagreed on whether Petitioners were entitled to refunds. The trial court awarded refunds of taxes paid "in excess of the amount legally due" under the state refund statute in the following amounts: Norwest, $189,065; First Security, $36,278; Cambridge, $23,833; and Midway, $46,574. (App. 42A-43A.) The Minnesota Supreme Court reversed, holding that refunds should be denied on grounds that are the subject of this petition, as set forth below.

1. **Estoppel.** Respondents argued in both the trial court and the Minnesota Supreme Court that Petitioners were estopped under the acceptance-of-benefits doctrine from challenging discrimination against federal obligations because Petitioners, who owned exempt state obligations as well as taxable federal obligations, did not pay a tax on exempt state obligation interest. Petitioners responded that they could not be required to make a contribution to the State of taxes they did not owe (i.e., taxes on exempt state obligation interest) as a precondition to challenging discrimination against federal obligations. The trial court agreed. (App. 25A-26A.) The Minnesota Supreme Court reversed, holding that Petitioners were estopped from challenging the discriminatory tax. (App. 8A.)

2. **Revocation of State Obligation Exemptions.** Respondents contended in both the trial court and the Minnesota Supreme Court that discrimination could (and should) be cured by revoking the exemptions for state obligations. They asked the court to impose a retroactive tax on state obligation interest in order to equalize the treatment of state and federal obligations. Respondents stipulated, however, that the State had not and would not collect such a tax. (App. 33A.) Petitioners argued that a fictional tax that would not and could not be collected would not cure the actual discrimination that existed in 1979.[2] The trial court agreed, holding that a fictional retroactive tax on state obligation interest "would, in substance and effect, uphold the unconstitutional discrimination against the federal obligations and deny [Petitioners] a remedy." (App. 33A.)

The Minnesota Supreme Court reversed. Purporting to distinguish this Court's decision last Term in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S. Ct. 2238 (1990), which rejected a similar fictional tax argument, the Minnesota Supreme Court held that discrimination would be cured by a fictional tax on state obligation interest that did not have to be collected. (App. 11A.) The court also stated that it would have ordered Respondents to assess and collect the tax on state obligation interest -- notwithstanding Respondents' stipulation to the contrary and notwithstanding that the tax would be retroactive for a period of eleven years -- but said that it was not necessary to do so in light of the court's ruling that *Memphis Bank* could be applied prospecti-

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[2] Prior to Respondents' stipulation that the tax on state obligation interest *would* not be collected, Petitioners also contended that a retroactive tax on state obligation interest *could* not be collected because (1) a tax on state obligation interest retroactive to the 1979 year at issue could not be imposed without violating the Due Process Clause, and (2) the statute of limitations would prevent collection of the tax from virtually all taxpayers. Petitioners also argued that, even if it were possible to impose and collect the tax, such action would not undo the discriminatory impact on federal borrowing costs in 1979.

vely only. (App. 11A-12A.)

3. **Prospective-Only Application of Memphis Bank.** Respondents contended in the trial court and the Minnesota Supreme Court that the bank excise tax should be treated as lawful for 1979, notwithstanding discrimination against federal obligations, through prospective-only application of the 1983 *Memphis Bank* decision. In response, Petitioners argued that prospectivity analysis was irrelevant because, even if prospective-only application were given to *Memphis Bank*, the bank excise tax would still have been unlawfully discriminatory under *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935), and *State v. Duluth, M. & N. Ry. Co.*, 207 Minn. 618, 624-28, 292 N.W. 401, 405-06 (1939), *reh'g denied*, 207 Minn. 637, 292 N.W. 411 (1940), *cert. denied*, 311 U.S. 719 (1940), both of which firmly established long before 1979 that a state tax is unconstitutional if it discriminates against holders of federal obligations. Petitioners also argued that, if it were necessary to reach the prospectivity issue, *Memphis Bank* had to be applied retroactively. The trial court held for the Petitioners on these issues. (App. 40A.) The Minnesota Supreme Court reversed. Without discussion of or even citation to *Schuylkill Trust* or *Duluth M. & N. Ry.*, the court applied *Memphis Bank* prospectively only.[3] (App. 12A-14A.)

REASONS FOR GRANTING THE WRIT

Since *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), this Court has prohibited states from imposing taxes that discrimi-

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[3] The three questions presented for review were argued by the parties in cross motions for summary judgment and *in limine* before the trial court. The trial court granted partial summary judgment for Petitioners that revocation of state obligation exemptions would not cure discrimination. (App. 32A-33A.) All motions pertaining to estoppel (App. 18A) and prospectivity (App. 33A) were denied. The trial court held for Petitioners on estoppel and prospectivity subsequent to trial.

nate against the Federal Government or those with whom it deals. Congress reaffirmed this principle in 1959 when it amended 31 U.S.C. § 742 to prohibit states from imposing discriminatory corporate franchise taxes on federal obligation interest. This Court in *Memphis Bank* unanimously held that the 1959 amendment was "principally a restatement of the constitutional rule" prohibiting discrimination, 459 U.S. at 397-99, and struck down a discriminatory bank excise tax nearly identical to the Minnesota bank excise tax here at issue.

The Minnesota Supreme Court conceded that the Minnesota bank excise tax was discriminatory in 1979 (App. 6A), but held that the State did not have to refund the unlawful tax despite full compliance by Petitioners with state refund procedures. The court justified its decision by noting that refunds would "cause a hardship to the State of Minnesota" and result in "an undeserved windfall" to Petitioners. (App. 13A-14A.)

The Tax Injunction Act, 28 U.S.C. § 1341, requires taxpayers subjected to unlawful taxation to seek redress in the state courts, even in cases involving violations of federal rights. It is unfortunately the case that some state courts, out of a concern for the state fisc, have been all too willing to excuse violations of federal rights by denying taxpayers meaningful relief in the form of refunds. This Court has reviewed a number of similar cases over the years, and has repeatedly and consistently granted certiorari to reverse such decisions.[4]

Just last Term, this Court decided four cases concerning the obligation of a state to provide refunds of unconstitutional taxes.

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[4] *See, e.g., Allegheny Pittsburgh Coal Co. v. County Comm'n*, 109 S. Ct. 633, 638-39 (1989); *Iowa-Des Moines Nat'l Bank v. Bennett*, 284 U.S. 239, 247 (1931); *Carpenter v. Shaw*, 280 U.S. 363, 369 (1930); *Montana Nat'l Bank v. Yellowstone County*, 276 U.S. 499, 504-05 (1928); *Sioux City Bridge Co. v. Dakota County*, 260 U.S. 441, 446-447 (1923); *and Ward v. Board of County Comm'rs*, 253 U.S. 17, 24 (1920).

See McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, 110 S. Ct. 2238 (1990); *American Trucking Ass'ns, Inc. v. Smith*, 110 S. Ct. 2323 (1990); *Ashland Oil, Inc. v. Caryl*, 110 S. Ct. 3202 (1990); *and National Mines Corp. v. Caryl*, 110 S. Ct. 3205 (1990). Collectively, these cases make it clear that a state *must* refund a tax that is "beyond the State's power to impose." *McKesson*, 110 S. Ct. at 2251. The Minnesota Supreme Court held that this principle had no application to violations of 31 U.S.C. § 742 and the doctrine of intergovernmental immunity, since each of the cases decided last Term involved the Commerce Clause.[5]

Petitioners ask that this Court grant certiorari to reverse. The *McKesson* rule ought to apply with even greater force in cases like the instant case, since the purpose of 31 U.S.C. § 742 and the doctrine of intergovernmental immunity is to protect Federal Government operations against the state and local pressures to which the Minnesota Supreme Court yielded in this case. This Court should make it unmistakably clear to the state courts that the remedial jurisprudence fashioned in the Commerce Clause context applies *a fortiori* where Congress has passed legislation to protect the Federal Government. The Court has never tolerated the denial of a remedy for a constitutional wrong, and should not do so here. If there be any doubt as to the need for certiorari, Petitioners request that the Court seek the views of the Solicitor General of the United States because of the paramount federal interest involved.

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[5] The Court also granted certiorari last Term in *James B. Beam Distilling Co. v. State*, 259 Ga. 363, 382 S.E.2d 95 (1989), *cert. granted*, 110 S. Ct. 2616 (1990). *Beam Distilling* raises the issue of whether *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), should be applied on a prospective-only basis. Like *McKesson*, *American Trucking*, *Ashland Oil* and *National Mines*, *Beam Distilling* is a Commerce Clause case.

I. The Minnesota Supreme Court's Decision Undermines the Doctrine of Intergovernmental Immunity by Denying Refunds of a Discriminatory Tax.

The decision of the Minnesota Supreme Court denying refunds to Petitioners undermines the rule of *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), that "a state tax may not discriminate against the Government or those with whom it deals." *Phillips Chemical Co. v. Dumas Indep. School Dist.*, 361 U.S. 376, 387 (1960), *reh'g denied*, 362 U.S. 937 (1960). If allowed to stand, the court's several grounds for refusing to provide a remedy for a constitutional wrong would soon destroy private actions to enforce intergovernmental immunity doctrine rights since the state courts, which historically have been reluctant to protect such rights, could always: (1) estop persons dealing with the Federal Government from challenging discriminatory taxes unless they first pay a sort of "poll" tax on otherwise exempt income for the privilege of making the challenge; (2) "cure" discrimination by ordering retroactive imposition (but not collection) of fictional taxes on previously exempt income that in theory -- but not in fact -- equalize tax burdens; and (3) refuse to follow decisions of this Court under the pretext of prospective decisionmaking.

The doctrine of intergovernmental immunity "is based on the need to protect each sovereign's governmental operations from undue interference by the other." *Davis v. Michigan Dept. of Treasury*, 109 S. Ct. 1500, 1507 (1989). The principle of nondiscrimination, which is "at the heart" of the immunity doctrine, "recognizes that the best safeguard against excessive taxation (and the most judicially manageable) is the requirement that the government tax in a nondiscriminatory fashion." *South Carolina v. Baker*, 485 U.S. 505, 525, n.15 (1988). "If anything is settled in the law, it is that a State may not discriminate against the Federal Government . . .." *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, 751, *reh'g denied*, 366 U.S. 947 (1961).

While the purpose of the immunity doctrine is to protect the

Federal Government, it is well settled that individuals and private entities who are subjected to discriminatory taxation on account of their dealings with the Federal Government are also entitled to constitutional protection. *Davis*, 109 S. Ct. at 1506-07. Allowing such persons to challenge discriminatory taxes serves to protect the Federal Government since the economic burden of such taxes is borne by the Federal Government. As a practical matter, because states (including Minnesota) commonly prohibit suits to enjoin the collection of taxes, private enforcement of rights protected by the immunity doctrine most often occurs in the context of an action for a refund of the unconstitutional tax. *See, e.g., Davis and Memphis Bank.* The Minnesota Supreme Court's decision denying refunds thus eviscerates private enforcement of immunity doctrine rights.

The threat to private causes of action under the immunity doctrine is a threat to the Federal Government itself. If refunds can be denied on the specious grounds advanced by Respondents in this case, then state governments can impose discriminatory taxes with impunity. The exposure to liability for refunds acts as a check on the temptations that exist for a state to benefit itself at the Federal Government's expense. Taxpayers will rarely have an incentive to challenge discrimination if there is no possibility of a refund. Indeed, if a challenge leads to higher taxes on state obligations, as it did in Minnesota, taxpayers would be well advised to allow discrimination to persist.

The issues raised in this case are important not only to the more than 700 taxpayers seeking refunds in Minnesota, but also to the future enforcement of the intergovernmental immunity doctrine generally. This Court has yet to address the prospectivity and remedial issues that arise when a state tax violates a federal statute. There is at present a particular need for guidance in this area because of the many suits pending in state courts in which refunds have been requested under 4 U.S.C. § 111, which prohibits discriminatory state taxation of federal retirees, as construed by this

Court in the *Davis* case.[6] Accordingly, Petitioners ask that certiorari be granted to reverse the decision of the Minnesota Supreme Court in this case.

II. The Minnesota Supreme Court's Holding That Petitioners Were Estopped from Challenging the Discriminatory Tax Denies Due Process and Results in Further Discrimination Against Holders of Federal Obligations.

The Minnesota Supreme Court held that Petitioners were estopped from challenging discrimination against federal obligations under 31 U.S.C. § 742 because Petitioners did not pay a judicially imposed tax on state obligation interest that was exempt under applicable state statutes. Because persons not having claims under 31 U.S.C. § 742 did not have to pay this tax, the Minnesota Supreme Court's holding in essence sanctions court-ordered "poll" taxes on the exercise of the right to enforce a federal statute. While this Court in *McKesson* observed that a state may adopt reasonable procedural rules (payment under protest, short statutes of limitations, escrow accounts, etc.) to protect its interest in sound financial planning, 110 S. Ct. at 2254, nothing in *McKesson* permits a state to impose a "poll" tax on the right to sue. Indeed, it is difficult to conceive of a more outrageous denial of a taxpayer's due process

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[6] *See Bass v. South Carolina*, No. 23216 (S.C. Sup. Ct. Aug. 6, 1990) (1990 S.C. LEXIS 164) (applying *Davis* prospectively only); *Bohn v. Waddell*, No. TX 89-00050 (Ariz. Bd. Tax App. Apr. 6, 1990) (1990 Ariz. Tax LEXIS 8) (awarding partial refunds only); *Tax News*, Iowa Department of Revenue (August 1990) (pending case addressing prospective application of *Davis* will affect status of 30,000 amended returns); Douglas, *State Tax and Budget Actions*, Tax Notes, July 30, 1990, p. 605 (reporting Montana trial court denial of retroactive relief in *Davis* action, with appeal to state supreme court likely); Eckl, Felde, Wolfe & Zimmerman, *State Taxation of Public Pensions: The Impact of Davis v. Michigan*, Tax Notes, May 28, 1990, pp. 1119, 1127 (*Davis* decision affected 24 states, with refund actions involving prospectivity and remedial questions pending in a number of those states).

right to "meaningful backward-looking relief to rectify any unconstitutional deprivation." *McKesson*, 110 S. Ct. at 2247.

Further, the effect of the court's holding would be to impose a requirement on persons holding federal obligations -- that they make a contribution of tax with respect to exempt income -- that is not imposed on taxpayers not holding federal obligations. As a precondition to challenging a discriminatory tax, taxpayers would have to pay an alternative form of discriminatory tax. Such discrimination itself runs afoul of 31 U.S.C. § 742 and the intergovernmental immunity doctrine.[7]

While the principal difficulties with the estoppel theory are that it denies due process and creates a discrimination against holders of federal obligations, other problems also exist. It is well settled that if constitutional protection from a tax is "denied on non-Federal grounds, it is the province of [the United States Supreme] Court to inquire whether the decision of the state court rests upon a fair or substantial basis." *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 282 (1932). The estoppel holding of the Minnesota Supreme Court is neither fair nor substantial.

First, the acceptance-of-benefits doctrine does not apply unless a claimant received a benefit from the very statute challenged as unconstitutional. *Kadrmas v. Dickinson Public Schools*, 487 U.S. 450, 457 (1988). Petitioners did not challenge the state obligation exemptions, the benefits of which they purportedly received. *See* Minn. Stat. § 474.12 (Supp. 1979) *and* Minn. Stat. § 136.32 (1978) (App. 52A-53A.) Rather, Petitioners challenged the tax on federal

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[7] No taxpayer has ever been estopped by this Court under the Minnesota Supreme Court's theory. If the theory were valid, then the taxpayers in *Memphis Bank* and *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935), both should have been estopped. Schuylkill Trust owned "shares of Pennsylvania corporations, exempt from tax, of the value of $135,787." 296 U.S. at 117. Memphis Bank had exempt interest income of $348,348 "on an investment of between $11 and $16.5 million in obligations of the State of Tennessee and its political subdivisions." Brief for Respondent at 35, n. 5, *Memphis Bank*.

obligation interest. *See* Minn. Stat. § 290.08, Subd. 13 (1978) (App. 48A.) They received no benefit from this tax. Receipt of benefits under one provision of state law does not act as an estoppel to a challenge of a "different provision of state law."[8] *Kadrmas*, 487 U.S. at 457.

Moreover, the "benefit" purportedly accepted by Petitioners is wholly illusory. Interest rates on exempt state obligations were lower than they would otherwise have been if the obligations had been taxable. (App. 24A.) Thus, while Petitioners received a tax exemption, they also received less interest from state obligation issuers because of the subsidy the tax exemption provided. The issuers of state obligations, whose interest costs were reduced, received the benefits of the exemptions here at issue, not the holders of state obligations. The acceptance-of-benefits doctrine does not apply when a benefit is "inapparent." *Kadrmas*, 487 U.S. at 457.

Unless the decision below is reversed, other state courts can adopt the Minnesota Supreme Court's estoppel theory and avoid the mandate of *McKesson* that taxpayers are entitled to a clear and certain remedy when they have paid an unconstitutional tax. Indeed, it seems likely that revenue-hungry states will extend this estoppel theory beyond the intergovernmental immunity area to preclude, for example, legitimate challenges to discriminatory

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[8] The instant case illustrates the unfairness of estopping a taxpayer from challenging a statute because the taxpayer received benefits under a different statute. Under the Minnesota Supreme Court's view, Petitioner Cambridge is estopped from recovering tax on $612,697 of federal obligation interest for having failed to pay tax on only $70,911 of state obligation interest. The detriment suffered by Cambridge is wholly disproportionate to the benefit allegedly received. Petitioners other than Cambridge also received significantly less state obligation interest than federal obligation interest.

taxation under the Commerce and Equal Protection Clauses.[9] The estoppel holding of the Minnesota Supreme Court thus clearly merits review, if not summary reversal, by this Court.

III. The Minnesota Supreme Court's Holding That Discrimination Could Be Cured by Imposing a Fictitious Tax on State Obligation Interest Is in Conflict with *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco* and Other Decisions of This Court.

The Minnesota Supreme Court held that it would cure discrimination against federal obligations by revoking the exemptions for state obligations and by judicially imposing a retroactive tax with respect to state obligation interest. However, the court held that this supposedly curative tax did not have to be collected. (App. 11A-12A.) This Court in *McKesson* rejected the argument that such a fictional uncollected tax was an adequate remedy for discrimination, describing a similar contention by the revenue authorities in that case as "contrived," "self-serving," and "inconsistent with the nature of the State's due process obligation." 110 S. Ct. at 2253. The Minnesota Supreme Court purported to distinguish *McKesson* because it was a Commerce Clause case in which actual collection was "necessary in order to cure the comparative economic disadvantage caused by the discriminatory

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[9] For example, the Court in *McKesson* noted that liquor distributors in Florida might sell beverages receiving unconstitutional tax preferences as well as beverages not receiving preferences. 110 S. Ct. at 2243, n. 3. Such a distributor would be estopped from challenging the discriminatory tax under the Minnesota Supreme Court's theory. Similarly, a taxpayer challenging discriminatory assessment of property taxes, as in *Allegheny Pittsburgh Coal Co. v. County Comm'n*, 109 S. Ct. 633 (1989), would be estopped if it also owned other property receiving preferred assessment.

tax."[10] (App. 11A.) This holding is indefensible.

There is not a scintilla of a suggestion in *McKesson* that this Court's rejection of fictional taxation as a cure to discrimination was intended to be limited to Commerce Clause cases. Indeed, the Court in *McKesson* discussed at some length its earlier decision in *Montana Nat'l Bank v. Yellowstone County*, 276 U.S. 499 (1928), which involved the application of a federal statute (§ 5219 of the Revised Statutes) requiring nondiscriminatory state taxation of national banks. 110 S. Ct. at 2248-50, 2252-53. The state court in *Montana Nat'l Bank* found that the tax as applied favored state banks over national banks and construed state law to eliminate the discrimination by imposing a higher tax on state banks. However, the court refused to order the higher tax to be collected from the state banks and it refused to order refunds of the higher tax that had been collected from the national banks. The United States Supreme Court reversed:

> Plaintiff in error cannot be deprived of its legal right to recover the amount of the tax unlawfully exacted of it by the later decision which, while repudiating the construction under which the unlawful exaction was made, leaves the moneys thus exacted in the public treasury.

276 U.S. at 504-05; *see also Iowa-Des Moines Nat'l Bank v. Bennett*, 284 U.S. 239, 247 (1931) (refund ordered where tax discriminated in violation of § 5219 of the Revised Statutes). Thus, a state's due process obligation to provide a clear and certain

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[10] The Minnesota Supreme Court also distinguished *Allegheny Pittsburgh Coal Co. v. County Comm'n*, 109 S. Ct. 633 (1989) which rejected a hypothetical reassessment of property values as a remedy where the taxpayer's property was valued higher than other similar properties. The court dismissed *Allegheny Pittsburgh Coal* as irrelevant because it was an equal protection case. (App. 10A.)

remedy should extend to cases -- including the instant case -- where a claim of discrimination arises under a federal statute applicable to the states under the Supremacy Clause.

To be sure, there is a difference between the instant case and the cases cited above, and that difference raises an important issue needing clarification by this Court. In both *McKesson* and *Montana Nat'l Bank*, the discrimination that existed favored one class of taxpayers over another. Thus, the actual collection of an equalizing retroactive tax from the favored class of taxpayers would cure the discrimination by treating all taxpayers the same. In the instant case, by contrast, Minnesota has favored issuers of state obligations, whose interest costs were lowered by the tax exemptions (App. 24A), and it has disadvantaged the Federal Government, which incurred higher interest costs on its borrowings because of the discriminatory tax. (App. 25A.) The interest rate *benefit* to state obligation issuers and *detriment* to the Federal Government are matters of historical record and cannot now be undone by a retroactive tax. Indeed, if the State were allowed to collect the tax on state obligations, it would benefit twice from its unconstitutional act: first, by lowering interest costs for favored issuers, and second by collecting a tax from holders of state obligations who accepted lower interest rates because the obligations were tax exempt.[11]

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[11] Although the Minnesota Supreme Court stated that it would override the parties' stipulation and order collection of the tax but for its holding that *Memphis Bank* applied prospectively only (App. 11A-12A), actual imposition of the retroactive tax would clearly violate the Due Process Clause. This Court in *McKesson* noted that "beyond some temporal point the retroactive imposition of a significant tax burden may be 'so harsh and oppressive as to transgress the constitutional limitation . . .'" 110 S. Ct. at 2252, n. 23, *quoting Welch v. Henry*, 305 U.S. 134, 147 (1938). A 1990 court-ordered imposition of a tax on state obligation interest earned in 1979 would clearly exceed the two-year period of retroactivity approved in *Welch*. It would also exceed the "short and limited periods" of retroactivity approved in *United States v. Darusmont*, 449 U.S. 292 (1981). Moreover, even if the tax could be imposed, it could not successfully be

(footnote continued on next page)

Since a retroactive tax on state obligation interest would not undo the constitutional wrong, the Minnesota Supreme Court should have affirmed the trial court's holding that the bank excise tax was void to the extent it applied to federal obligation interest. This Court in *McKesson* observed that when a tax is "beyond the State's power to impose," then the state has "no choice but to 'undo' the unlawful deprivation by refunding the tax . . .." 110 S. Ct. at 2251. *Cf. Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, 752 (1961), *reh'g denied*, 366 U.S. 947 (1961) (intergovernmental immunity case in which discriminatory tax held void); *Phillips Chemical Co. v. Dumas Indep. School Dist.*, 361 U.S. 376, 387, *reh'g denied*, 362 U.S. 937 (1960) (same).

This Court has yet to address the remedial issues involved when a tax is unlawful under the intergovernmental immunity doctrine and 31 U.S.C. § 742. Petitioners respectfully ask that the Court do so in this case, and that it hold that the principles set forth in *McKesson* apply with even greater force in the intergovernmental immunity context.

IV. The Minnesota Supreme Court's Holding Applying *Memphis Bank & Trust Co. v. Garner* Prospectively Only Is in Conflict with This Court's Decisions in *American Trucking Ass'ns, Inc. v. Smith* and *Ashland Oil, Inc. v. Caryl.*

Federal law (31 U.S.C. § 742) permits a state to levy a corporate franchise tax measured by net income, including interest on federal obligations, only if the tax is nondiscriminatory. In *Memphis Bank*, the United States Supreme Court held that a

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collected since the statute of limitations to assess tax deficiencies in Minnesota is generally 3-1/2 years from the filing of a tax return. Minn. Stat. § 290.49, Subd. 1 (1988). This period has long since expired for 1979.

Tennessee bank tax "impermissibly discriminated" because federal obligation interest was taxable while state obligation interest was exempt. Although it conceded that the 1979 Minnesota bank excise tax was discriminatory under 31 U.S.C. § 742 as construed in the 1983 *Memphis Bank* decision, the Minnesota Supreme Court held that it would apply *Memphis Bank* prospectively only. (App. 12A.) This holding is in obvious conflict with this Court's prospectivity decisions last Term. *See American Trucking Ass'ns, Inc. v. Smith*, 110 S. Ct. 2323 (1990), *and Ashland Oil, Inc. v. Caryl*, 110 S. Ct. 3202 (1990).

The plurality in *American Trucking*, following *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), held that a United States Supreme Court decision cannot be given prospective-only application unless it overrules clear past precedent or otherwise announces a revolutionary change in the law. *American Trucking*, 110 S. Ct. at 2331-32; *Ashland Oil*, 110 S. Ct. at 3204-5. The Minnesota Supreme Court held that *Memphis Bank* must have significantly changed prior law because Petitioners did not bring suit until after the case was decided. (App. 13A.) The court relied upon a prior decision by the Oklahoma Supreme Court that limited *Memphis Bank* to prospective cases because "[a]lthough the new principle of law established in *Memphis Bank* might be characterized as merely a progression from former decisions, it was not foreseen by the Commission, nor by the Oklahoma Legislature." *First of McAlester Corp. v. Oklahoma Tax Comm'n*, 709 P.2d 1026, 1036 (Okla. 1985). (App. 14A.)

This reasoning is completely at odds with the prospectivity decisions of the United States Supreme Court. A decision does not establish a new principle of law if it merely extends constitutional doctrine "beyond the context in which it originated." *Ashland Oil*, 110 S. Ct. at 3205. Moreover, the issue is not whether Petitioners or Respondents were aware of the discrimination or actually foresaw the decision in *Memphis Bank*. Whether a decision should

be applied prospectively only "does not rest on the subjective interpretations of discrete, affected persons and their legal advisers." *Florida v. Long*, 487 U.S. 223, 237 (1988), *reh'g denied*, 487 U.S. 1263 (1988). The issue is an objective one: Did *Memphis Bank* "overrule clear past precedent" or "decide a wholly new issue of first impression." *Ashland Oil*, 110 S. Ct. at 3205.

The answer is no. *Memphis Bank* did not overrule a prior decision or decide a wholly new issue. The Court in *Memphis Bank* noted that it had "frequently considered" the nondiscrimination rule in its intergovernmental immunity decisions going back to *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), and that 31 U.S.C. § 742 was "principally a restatement of the constitutional rule." 459 U.S. at 396-97. The Court observed that it had squarely held in *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935), that the states may not impose taxes with respect to federal obligations that are not equally imposed with respect to obligations issued by a state or anyone else. 459 U.S. at 396-98. After review of *Schuylkill Trust* and its other nondiscrimination precedents, the Court held *unanimously* that its decision in *Memphis Bank* was "clear . . . under the principles established in our previous cases . . . ." 459 U.S. at 398.

A decision that is "clear" under principles established in earlier cases does not decide a "wholly new issue of first impression." *Cf. Ashland Oil*, 110 S. Ct. at 3205. Indeed, the nondiscrimination principle was so firmly established prior to *Memphis Bank* that in 1939 the Minnesota Supreme Court itself, in reliance upon *Schuylkill Trust*, struck down a corporate excise tax that discriminated against federal obligations. *See State v. Duluth M. & N. Ry. Co.*, 207 Minn. 618, 292 N.W. 401 (1939), *reh'g denied*, 207 Minn. 637, 292 N.W. 411 (1940), *cert. denied*, 311 U.S. 719 (1940). The Minnesota Supreme Court in the instant case simply refused to acknowledge the existence of *Schuylkill Trust* and *Duluth M. & N. Ry.* Because no new principle of law was announced in

Memphis Bank, the Minnesota Supreme Court had no basis upon which to apply *Memphis Bank* prospectively only.

The Minnesota Supreme Court's prospectivity holding cannot be dismissed as only a mistaken application of *Chevron Oil*. Rather, the prospectivity holding is clearly no more than a pretext designed to cover the court's blatant disregard for federal constitutional rights which, if enforced, would have a fiscal impact on the State. State courts should never be permitted to evade the consequences of United States Supreme Court decisions through wholly specious prospectivity rulings. Petitioners therefore urge that certiorari be granted and the decision below reversed.

A further, equally compelling, reason exists for granting certiorari in this case. The four dissenting justices in *American Trucking* stated that prospective application is not permissible in any case involving a substantive issue of law. In the view of the dissent, such decisions apply retroactively to all cases under adjudication. 110 S. Ct. 2355-56. Justice Scalia indicated that he would join the dissenters to form a majority in support of this position in a case -- such as the instant case -- not involving "negative" Commerce Clause jurisprudence. 110 S. Ct. at 2343-45. Justice Scalia observed: "Since the Constitution does not change from year to year; since it does not conform to our decisions, but our decisions are supposed to conform to it; the notion that our interpretation of the Constitution in a particular decision could take prospective form does not make sense." *American Trucking*, 110 S. Ct. at 2343 (Scalia, J., concurring).

Petitioners agree that it is inconsistent with the judicial function for courts to decide when interpretations of constitutional law shall go into effect. Petitioners think it equally clear that courts, when interpreting statutes, do not have the power to override a legislative determination regarding the statute's effective date. The Minnesota Supreme Court had no authority to refuse to apply

the 1959 statute's nondiscrimination rule to 1979.[12] Petitioners therefore request that the Court grant certiorari to so hold.

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[12] The statue at issue in this case, an amendment to 31 U.S.C. § 742, was adopted and became effective on Sept. 22, 1959. Act of September 22, 1959, Pub. L. No. 86-346, § 105(a), 73 Stat. 621, 622.

CONCLUSION

For the reasons set forth above, Petitioners request that this petition for certiorari be granted.

Respectfully submitted,

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IN SUPREME COURT

No. C0-89-2097

Ramsey County

Yetka, J.
Concurring specially, Kelley, J.

Cambridge State Bank, et al.,

Respondents,

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Filed July 20, 1990
Office of Appellate courts

Respondent,

vs.

Arthur C. Roemer, Commissioner, Department of Revenue, and the State of Minnesota,

Appellants.

SYLLABUS

1. A taxpayer who assumes the validity of a statute by invoking its provisions in order to obtain a tax benefit is estopped from attacking the statute's constitutionality.

2. Where it is clear that the legislature would have enacted a statute without the provisions which are unconstitutional, the proper procedure is to apply Minn. Stat. § 645.20 (1988) and sever the invalid provisions.

3. Pursuant to the three-part test set forth in Chevron Oil Co. v. Huson, 404 U.S. 97, 106-07 (1983), the United States

Supreme Court's decision in Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), must be applied prospectively.

Affirmed in part, reversed in part.

Heard, considered and decided by the court en banc.

OPINION

YETKA, Justice.

In the autumn of 1984, respondent banks commenced a tax refund claim in the district court of Ramsey County pursuant to Minn. Stat. § 290.50, subd. 2 (1988). This consolidated action by over 170 Minnesota banks sought tax refunds for the tax years 1979 through 1983. The district court concluded that the pre-1983 Minnesota bank excise tax imposed by Minn. Stat. § 290.361 (1984) (repealed 1987) is, in substance, an income tax and discriminates against federal debt instruments in violation of the borrowing and supremacy clauses of the United States Constitution. The court found that the inclusion of interest from federal obligations in the calculation of the banks' franchise tax was discriminatory and, therefore, in violation of 31 U.S.C. § 3124(a) (1982) (formerly numbered § 742)[1] because interest from certain state obligations was exempt from the calculation of the tax. The district court ordered the State of Minnesota to refund to respondents, with interest, taxes collected under the statute between 1979 and 1983. We affirm in part and reverse in part.

The record in this case includes a detailed stipulation of facts entered into by the parties. The trial was bifurcated into two

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[1] 31 U.S.C. §3124 (1982) provides:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except---
>
> (1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation * * * .

(Emphasis added.)

phases: Phase I, a liability phase, and Phase II, a remedy phase. The issue of liability was tried before the court on November 6-17, 1986. By agreement of counsel and order of the court, evidence was presented by four banks for the 1979 tax year. The four banks were: Cambridge State Bank, Midway National Bank of St. Paul, First Security State Bank of Sleepy Eye, and Norwest Bank Duluth. The court heard lengthy and detailed testimony from several expert witnesses concerning the economic impact of the tax on the borrowing power of the federal government. The parties agreed that the conclusion of the court on the liability phase would be conclusive as to all tax years at issue and all of the plaintiff banks. Pursuant to statute, the measure of the tax paid by these banks included interest income earned on obligations of the United States government, but did not include interest income earned by the banks on obligations of certain agencies of the State of Minnesota. Respondents filed timely protective claims for refunds for the tax year 1979 and timely filed these actions for refunds.

The trial court concluded that the tax violated 31 U.S.C. § 3124. In summary, section 3124 provides that obligations of the United States government are immune from state and local taxation, but interest earned on these obligations may be included in the measure of a "non-discriminatory" corporate franchise tax. The trial court concluded that the Minnesota tax was a discriminatory income tax and, therefore, violated the supremacy and borrowing clauses of the United States Constitution. The court's conclusion regarding discrimination was premised on a finding that, under Minnesota law, interest earned on obligations of the United States Government was included in the computation of the corporate franchise tax whereas interest earned on certain obligations[2] of the State of

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[2] Appellants dispute the number of obligations that are exempt from the computation of the corporate franchise tax. Appellants concede, however, that at (footnote continued on next page)

Minnesota was exempt from the computation of the corporate franchise tax.

The trial court also concluded that, although the tax imposed by Minn. Stat. § 290.361 (1984) is labeled an "excise" tax, it is a direct tax on net income for purposes of federal statutory and constitutional law. The trial court rejected all of appellants' arguments and ordered that the appellants were liable for refunds in amounts to be determined in Phase II of the trial. On August 28, 1989, following phase II of the trial, the court ruled that appellants were liable for refunds, with interest, and ordered retroactive relief in the following amounts: Norwest-$189,065; Sleepy Eye-$36,278; Cambridge-$23,833; and Midway-$46,574. This appeal followed.

I. The first issue raised by this appeal is whether the bank tax imposed under section 290.361 and governed by Minn. Stat. § 290.02 (1988) is a non-discriminatory franchise tax. This court has determined that the tax imposed by section 290.02 is a franchise tax. Reuben L. Anderson-Cheme, Inc. v. Commissioner of Taxation, 303 Minn. 124, 226 N.W.2d 611, appeal dismissed, 423 U.S. 886-87 (1975) (dismissed for lack of substantial federal question). Respondents ask this court to overrule Reuben on the grounds that, in "economic effect," the tax is an income tax. According to this theory, the tax would clearly violate 31 U.S.C. § 3124 and would, therefore, be unconstitutional under the borrowing clause of the United States Constitution. The trial court accepted this theory and concluded that the tax is an income tax. We disagree.

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least two state/municipal obligations were exempt:

(1) Industrial Development Bonds issued under Minn. Stat. ch. 474 prior to June 30, 1979; and

(2) State University Bonds issued under Minn. Stat. § § 136.31-.38;

Given that the parties have stipulated that at least some state obligations were exempt, this court need not reach the issue of whether the other types of obligations were actually exempt.

The trial court's conclusion on this issue is inconsistent with the legislative history of section 3124 and Reuben. In American Bank & Trust Co. v. Dallas County, 463 U.S. 855, 870-71, n. 13 (1983), the United States Supreme Court observed that the inability of states to include interest from federal obligations in an income tax was the primary reason for enacting tax legislation permitting the imposition on national banks of non-discriminatory franchise taxes based on corporate income. Thus, the exception for non-discriminatory franchise taxes measured by income appears to be an intentional elevation of form over substance in recognition of the fact that banks would otherwise operate totally tax free.

In Reuben, this court noted that 31 U.S.C. § 3124 was amended in 1959 so as to permit the inclusion of interest from federal obligations in the computation of a non-discriminatory franchise tax and reasoned that to conclude the tax imposed by section 290.02 was, in reality, an income tax would render the 1959 amendment "completely meaningless." See Reuben, 303 Minn. at 130, 226 N.W.2d at 615. The Reuben court's determination that the tax levied on the income from interest on government obligations is a franchise tax is supported by this court's decision in Soo Line R.R. Co. v. Commissioner of Revenue, 377 N.W.2d 453 (Minn. 1985), where the court observed that "[t]he incident of the franchise taxed under the excise tax,[3] however, is the privilege of carrying on business, not the property of the franchise." Id. at 455 (emphasis and footnote added; citation omitted). The reasoning of the Reuben court is also supported by the United States Supreme Court's observations in American Bank & Trust. Accordingly, we reverse the trial court's conclusion that the bank tax is an income

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[3] An excise tax is a tax imposed on the performance of an act, the engaging in of an occupation, or the enjoyment of a privilege, including corporate privileges. In current usage, the term includes practically every internal revenue tax except the income tax. Black's Law Dictionary 506 (5th ed. 1979).

tax for purposes of section 3124 and conclude instead that it is a franchise tax. As a result, the next question is whether it is "non-discriminatory."

Our review of the relevant statutes convinces us that the tax in question is discriminatory. Banks doing business in the State of Minnesota during the relevant period were required to pay a tax measured by their net income. Minn. Stat. § 290.361, subd. 1. That tax was governed by the provisions of Minn. Stat. § 290.02. Id. Both Minn. Stat. § § 290.02 and 290.361 referred to an "excise" tax measured by taxable net income. Minn. Stat. § 290.08, subd. 8 (1984) (repealed 1987) exempted any interest earned on either United States or State of Minnesota obligations from gross income. That exclusion, however, was not applicable to "corporations taxable under section 290.02 or 290.361." Id. (emphasis added). Consequently, for banks doing business in the State of Minnesota, interest earned on federal obligations was included in the taxable net income figure used to compute their chapter 290 excise tax. Certain state bond enabling statues, however, overrode the above provisions of chapter 290 and exempted interest earned thereon from inclusion in income for the purpose of calculating chapter 290 taxes. See Minn. Stat. § 136.32 (1982) (amended 1983) ("SUB's"); Minn. Stat. § 474.12 (1982) (repealed 1983) (Municipal Industrial Development Bonds ("IDB's")).[4]

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[4] The trial court also found that interest earned on obligations of the following State of Minnesota agencies was exempt from inclusion in the bank tax:

Minnesota Higher Education Coordinating Board Bonds
Minnesota Higher Education Facilities Authority Bonds
Metropolitan Transit Commission Bonds
Public Water and Sewer Bonds
Hospital District Bonds
Hospital Revenue Bonds
St. Cloud Transit Commission Bonds
Metropolitan Waste Control Commission Bonds
Housing Redevelopment Authority Bonds

(footnote continued on next page)

The trial court, in reliance on Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 398 (1983), concluded that, during the 1979 through 1983 calendar years, the bank tax was discriminatory because interest from certain State of Minnesota obligations was exempt.[5] Appellants concede that, at least as to IDB's and SUB's, the bank tax is discriminatory. Although we question the judgment of appellants in making this concession, the trial court's conclusion that the bank tax was discriminatory is affirmed as the law of this case.

II. The second issue presented by this appeal is whether the bank tax falls within a de minimis exception to section 3124. Appellants argue that the impact of the bank tax on the borrowing power of the United States government is de minimis and, therefore, the constitutional defects should be ignored. Appellants' de minimis defense is apparently based on dicta in Memphis Bank & Trust where, in a footnote, the Court stated:

> We cannot regard the impact of the discrimination as de minimis. According to the United States, which filed a brief as amicus curiae in support of reversal, if all 50 States enacted provisions comparable to the Tennessee bank tax, the United States would incur additional annual borrowing costs estimated at $280 million at an interest rate of 12%.

Id. at 398 n.8 (citation omitted).

In the present case, the trial court concluded that there is no

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Area Redevelopment Agency Bonds
Minnesota State Armory Commission Bonds
Solid Waste Management District Bonds

[5] In 1983, the Minnesota Legislature repealed the exemption provisions contained in numerous state obligation enabling statutes. Act of May 20, 1983, ch. 213, 1983 Minn. Laws 613, 614-25.

de minimis defense and found that, even if there were such an exception, "[t]he economic incidence of this discrimination would be far from de minimis, reaching into the billions of dollars of increased federal expense." We cannot say that the trial court's finding was clearly erroneous; thus, we conclude that the impact of the bank tax on federal borrowing was not de minimis. Accordingly, even assuming, arguendo, that there is a de minimis exception to section 3124, it is not applicable in the instant case.

III. Appellants argue that respondents should be estopped from asserting their claims that exemption of IDB's and SUB's from the bank tax discriminated against federal obligations under the acceptance-of-benefits doctrine. In Gale v. Commissioner of Taxation, 228 Minn. 345, 37 N.W.2d 711 (1949), the taxpayer sought to invoke the provisions of a tax statute to secure the benefit of a tax computation and, at the same time, challenged the constitutionality of another provision of the same act. Id. at 352, 37 N.W.2d at 716. This court said "[H]e who assumes the validity of a statute by invoking its provisions to obtain a tax reduction may not attack its constitutionality." Id. (citing Byard v. Commissioner of Taxation, 209 Minn. 215, 296 N.W. 10 (1941).

Respondents do not dispute that they accepted the tax benefits of the exemption for interest on State of Minnesota obligations. Instead, respondents suggest that the acceptance-of-benefits doctrine of estoppel is no longer good law. In Wegan v. Lexington, 309 N.W.2d 273, 277 (Minn. 1981), this court did not reject the acceptance-of-benefits doctrine in tax cases like Gale and Byard. See Wegan at 277. We conclude, therefore, that, under the rule in Gale, respondents should be estopped from challenging the constitutionality of the bank tax. We do not, however, decide this case on that ground alone.

IV. Based on Minn. Stat. § 645.20 (1988), appellants ask this court to declare the language in the various state obligation enabling statues which exempt the interest earned thereon from

taxation to be unconstitutional and sever it from the remaining portion of the statutes. This is a compelling argument. Minn. Stat. § 645.20 (1988) provides, in pertinent part, as follows:

> If any provision of a law is found to be unconstitutional and void, the remaining provisions of the law shall remain valid, unless the court finds the valid provisions of the law are so essentially and inseparably connected with, and so dependent upon, the void provisions that the court cannot presume the legislature would have enacted the remaining valid provisions without the void one * * * .

It is the exemption for interest earned on state obligations that makes the bank tax discriminatory and, therefore, unconstitutional. Moreover, since the legislature amended the statutes in question by deleting the challenged exemptions, this court can presume that the legislature would have enacted the remaining provisions without the void one.

Indeed, when the legislature adopted the bank franchise tax in 1941, it did not exempt the disputed state interest revenue. See Act of Feb. 21, 1941, ch. 18, § 4, 1941 Minn. Laws 23, 24. The provisions exempting interest of certain state obligations were not enacted until 1957 and 1967. Act of Apr. 24, 1957, ch. 603, § 2, 1957 Minn. Laws 753 (SUB's); Act of May 4, 1967, ch. 297, § 12, 1967 Minn. Laws 456, 465 (IDB's). Can it be said that these later additions invalidated the entire original act? We think not. Since the original act was valid, the subsequent amendments, if unconstitutional, may be severed from the original act which remains valid.

In Johnson Bros. Wholesale Liquor Co. v. Commissioner of Revenue, 402 N.W.2d 791 (Minn. 1987), this court affirmed the tax court's use of a similar remedy in addressing a discriminatory tax on wine sales. See id. at 793. The Johnson Bros. court also observed that the United States Supreme Court has recognized that a withdrawal of benefits from the favored class is an acceptable

remedy for unconstitutional discrimination. Id. (citing Iowa-Des Moines Nat'l Bank v. Bennett, 284 U.S. 239, 247 (1931). In the case at bar, the trial court simply did not apply section 645.20. Section 645.20 indicates, however, subject to certain qualifications which are not applicable in this case, that if any provision of a law is found to be unconstitutional, severance is mandatory and the remaining provisions are valid. Accordingly, this court concludes that the trial court abused its discretion in refusing to apply section 645.20 and is, therefore, reversed.

Respondents seek to avoid such a result by emphasizing that the Minnesota Department of Revenue has stipulated that it will not collect Minnesota bank taxes on interest earned from SUB's issued pursuant to Minn. Stat. § 136.31-38 or from IDB's issued prior to July 1, 1979. This stipulation arguably distinguishes the present case from Johnson Bros. wherein the Revenue Department actually collected the back taxes from the unlawfully favored wineries. See Johnson Bros. at 792.

Respondents cite Allegheny Pittsburgh Coal Co. v. County Commissioner of Webster County, 488 U.S. 336, 109 S. Ct. 633 (1989), as authority for the proposition that discriminatory taxation is not cured by raising a tax on someone else. However, they fail to point out that Allegheny was an equal protection property tax case presenting significant valuation problems and did not involve a statutory mandate such as Minn. Stat. § 645.20. Respondents also cite Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 267-81 n.7 (1984), but again fail to discuss significant differences between that case and this one. In Bacchus, the State of Hawaii imposed a 20% excise tax on wholesale liquor, but exempted certain locally manufactured alcoholic beverages. Wholesalers of nonexempt beverages challenged the tax as violative of the commerce clause. In the footnote cited by respondents, the United States Supreme Court noted that the severance issue was not presented to the Supreme Court of Hawaii in the case below and merely commented

in passing that "severance" would not relieve the harm inflicted. Bacchus, 468 U.S. at 267-68 n.7.

The recent decision in McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, ___ U.S. ___, 58 U.S.L.W. 4665 (June 4, 1990), makes clear that a state may cure the invalidity of a discriminatory tax by assessing and collecting back taxes from those who benefited from the discrimination. Id. at 4671. Although the Court concluded in McKesson that, in commerce clause cases, a state that selects this remedy must actually impose a retroactive tax, that conclusion was premised on the fact that actual collection is necessary in order to cure the comparative economic disadvantage caused by the discriminatory tax. See id. at 4671-72. The present case is distinguishable from McKesson because there is no need to remedy any comparative economic disadvantage. Accordingly, we hold that severing the invalid exemptions renders the bank excise tax non-discriminatory and thereby satisfies the due process requirement of a fully adequate post-deprivation remedy.

More fundamentally, even if actually collecting the tax is a prerequisite to curing the constitutional infirmity of the tax in question, respondents do not explain where the Revenue Department gets the authority to limit this court's power to fashion an appropriate remedy for an unconstitutional tax. See Amundson v. Cloverleaf Memorial Park Ass'n, 221 Minn. 353, 358, 22 N.W.2d 170, 172 (1946) (suggesting that mistake and lack of authority are grounds for relieving a party from a stipulation).[6] Were it not for our conclusion that the Memphis Bank case established a new principle of law that was not clearly foreshadowed, we would order the Revenue Department to assess and collect the tax attributable to the state obligation interest income. We believe that ordering actual

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[6] When confronted with similar options, the Nebraska Supreme Court also chose to sever the unconstitutional exemptions. State ex rel. Douglas v. Karnes, 216 Neb. 750, 760, 346 N.W.2d 231, 236 (1984).

collection of the tax in this case would unfairly penalize both parties for failing to foresee the change in the law brought about in Memphis Bank. Consequently, we reject the respondents' contention that actual imposition of back taxes is necessary in this case.

An additional reason for reversing the trial court is that it inappropriately applied the Memphis decision retroactively. The three factors governing non-retroactive application of judicial decisions were set forth in Chevron Oil Co. v. Huson, 404 U.S. 97 (1971), as follows:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed. Second, it has been stressed that "we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." Finally, we have weighed the inequity imposed by retrospective application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

Id. at 106-07 (citations omitted). Applying these factors to the present case, we conclude that the decision in Memphis should be given prospective application only.

First, since the legislature passed the first state obligation interest exemption to the bank franchise tax in 1957, more that 20 years elapsed before these taxpayers questioned the validity of this exemption. Yet, respondents argue that the Memphis case should be applied retroactively because it was not, they aver, a case

deciding an issue of first impression whose resolution was not clearly foreshadowed. The fact that this case was not brought until immediately after the Memphis case was decided, however, completely eviscerates the argument that the Memphis decision was clearly foreshadowed.

Second, the primary purpose of section 3124 is to protect the borrowing power of the United States Government. See Memphis Bank, 459 U.S. at 396 (referring to the congressional intent to prevent taxes which diminish the value of United States obligations). Respondents have not explained how the borrowing power of the United States will be protected by allowing them to receive multimillion dollar refunds. It seems to us that the purpose of promoting investments in United States obligations and protecting the borrowing power of the United States Government will be just as adequately advanced by prospective application as it will by retroactive application. This is especially true given that, soon after Memphis Bank was decided, the Minnesota Legislature met and repealed the disputed exemptions for Minnesota obligations. Act of May 20, 1983, ch. 213, 1983 Minn. Laws 613, 613-25.

Finally, in weighing the equities involved in this case, it is obvious that retroactive application of the Memphis Bank decision would cause a hardship to the State of Minnesota. The excise taxes in question have long since been spent by the state in providing, among other things, regulatory and other public services for all taxpayers, including the respondent banks. See First Nat'l. Bank of Fredericksburg v. Commonwealth, 553 A.2d 937, 947 (Pa. 1989) (Larsen, J., dissenting). By comparison, no equivalent hardship results to the banks by a prospective application of the decision in Memphis Bank. On the contrary, respondents' taxes were actually reduced during the years the state obligation interest exemptions were mistakenly in effect. If the Memphis Bank decision is applied retroactively, respondent banks will have operated essentially tax-free during the period in question and would receive a refund of

taxes that were, in effect, paid by others. Such a result would provide respondent banks with an undeserved windfall. As corporate citizens, these banks should not be allowed to enjoy the benefits of the privilege of doing business in the State of Minnesota without paying taxes.

In construing the very same issue, the Oklahoma Supreme Court in First of McAlester Corp. v. Oklahoma Tax Commission, 709 P.2d 1026 (Okla. 1985), also decided that Memphis Bank should be applied prospectively only. The McAlester court stated:

> It is arguable that previous case law foreshadowed the Memphis Bank pronouncement. It is equally persuasive that the type of bank tax in question might reasonably have been assumed to be constitutional based on the longstanding and widespread practice of various states to which the United States Supreme Court had not specifically spoken.
>
> * * *
>
> Although the Memphis Bank case does not involve a reversal of a United States Supreme Court decision as in Texas Company, it does decide a new principle of law. * * *
>
> Although the new principle of law established in Memphis Bank might be characterized as merely a progression from former decisions, it was not foreseen by the Commission, nor by the Oklahoma Legislature.

Id. at 1034-36. We believe that the position of the Oklahoma court is sound. See also American Trucking Ass'ns, Inc. v. Smith, ___ U.S. ___, 58 U.S.L.W. 4704 (June 4, 1990) (applying the Chevron Oil test in upholding the Arkansas Supreme Court's prospective application of a United States Supreme Court decision which established a new principle of law).

For all of the above reasons, the trial court is reversed in its

finding that the Minnesota bank franchise tax is an income tax and in the remedies it imposed. Respondents' request for refunds is denied in all respects.[7]

KELLEY, Justice (concurring specially)

I concur in the result; although I do not join that part of the opinion that purports to hold that the banks should be estopped from challenging the constitutionality of the bank tax.

[7] Because of our other rulings in this case, we need not decide the issue of whether the trial court erred in refusing to reduce the ordered tax refunds by amounts allegedly allocable to the production of the interest income.

STATE OF MINNESOTA — DISTRICT COURT

COUNTY OF RAMSEY — SECOND JUDICIAL DISTRICT

---------- — CASE TYPE: OTHER CIVIL

Cambridge State Bank, et al.,

Plaintiffs,

vs. — File No. 469151

Arthur C. Roemer, Commissioner, Department of Revenue, State of Minnesota,

Defendant.

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Plaintiff,

vs. — File No. 469547

Arthur C. Roemer, in his capacity as Commissioner of Revenue, and the State of Minnesota,

Defendants.

FINDINGS OF FACT,
CONCLUSIONS OF LAW,
AND ORDER ON PHASE I LIABILITY

These consolidated cases came on for trial before the Honorable Harold W. Schultz, Judge of the District Court, on October 31, November 5, 6, 7, 12, 13, 14, and 17, 1986, in Courtroom 1315, Ramsey County Courthouse, St. Paul, Minnesota.

CHRISTOPHER J. DIETZEN, ESQ., and ANDREW J. MITCHELL, ESQ., of the law firm of LARKIN, HOFFMAN, DALY & LINDGREN, LTD., 1500 Northwestern Financial Center, 7900 Xerxes Avenue South, Bloomington, Minnesota 55431, appeared representing Plaintiffs Cambridge State Bank, et al.

JAMES P. MC CARTHY, ESQ., and LAURENCE R. WALDOCH, ESQ., of the law firm of LINDQUIST & VENNUM, 4200 IDS Center, Minneapolis, Minnesota 55402, appeared representing Plaintiffs Cambridge State Bank, et al.

ROBERT L. SCHNELL, JR., ESQ., of the law firm of FAEGRE & BENSON, 2300 Multifoods Tower, Minneapolis, Minnesota 55402-3694, and WALTER A PICKHARDT, ESQ., of the law firm of FAEGRE & BENSON, Suite 1150, 8400 Tower, 8400 Normandale Lake Boulevard, Bloomington, Minnesota 55437-1076, appeared representing Plaintiff Norwest Bank Duluth.

THOMAS R. MUCK, ESQ., Deputy Attorney General, and JAMES W. NEHER, ESQ., Special Assistant Attorney General, Second Floor, Centennial Office Building, St. Paul, Minnesota 55145, appeared representing the Defendants.

Court File No. 469151 was commenced by over 170 banks who are seeking tax refunds from the State of Minnesota for alleged over-payment of taxes in the years 1979 to 1983. Court File No. 469547 involves a similar claim on behalf of the Norwest Bank Duluth for the year 1979. The Court is informed that there are other cases pending in other jurisdictions within the State of

Minnesota involving the same issues.

By agreement of counsel and order of this Court, this case was bifurcated into separate trials on the issues of liability and damages. These Findings and Conclusions concern the liability portion of the trial.

By further agreement of counsel and order of this Court the matter was presented on a test case basis. Evidence was presented by four banks for the 1979 tax year. The four banks were: The Cambridge State Bank, Midway National Bank of St. Paul, First Security State Bank of Sleepy Eye, and Norwest Bank Duluth. The parties agreed that the conclusion of the Court on the liability phase would be conclusive as to all tax years at issue and all of the plaintiff banks.

Prior to the commencement of trial both parties submitted motions in limine. The plaintiffs moved for summary judgment on liability or, in the alternative, for an order to exclude certain evidence as irrelevant. The defendants moved for leave to amend their answers to assert an additional affirmative defense and for dismissal of the plaintiffs' complaints. After consideration, this Court granted the defendants' motion for leave to amend and denied all other pretrial motions. At the same time, this Court ruled that the defendants had the burden of establishing as affirmative defenses their claim with respect to the so-called issues of "comparability" and "de minimis impact."

At the inception of the trial the parties submitted a Stipulation of Facts (Plaintiffs' Exhibit 1) and attached exhibits (Plaintiffs' Exhibit 2) which were received into evidence. Based on those submissions, plaintiffs rested.

Thereafter, defendants presented their testimony on the affirmative defenses mentioned above. Defendants' witnesses were Mr. Delos Steenson and Dr. Timothy J. Nantell. Plaintiffs presented rebuttal testimony from Dr. Sung Won Sohn, Dr. John H. Kareken, and Dr. David Wyss. After defendants' rebuttal testimony

from Dr. Nantell, the trial concluded.

Having heard the testimony presented, and upon all of the evidence, files, records, and proceedings herein, the Court makes the following Findings of Fact, Conclusions of Law, and Order.

INITIAL FINDINGS

1. Several of the Findings of Fact that follow are summaries of facts detailed in the Stipulation of Facts. (See Plaintiffs' Exhibits 1 and 2.) All facts stipulated to in those two exhibits are explicitly found to be facts by this Court, although they will not be recited individually here in the interests of readability and brevity.

2. Each of the plaintiff banks paid taxes to the State of Minnesota for the tax year 1979 pursuant to Minn. Stat. § 290.361. (Stipulation of Facts, paragraph 1.)

3. Pursuant to statute, the measure of the tax paid by these banks included interest income earned on obligations of the United States Government. These obligations included U.S. Treasury Notes, U.S. Treasury Bills, U.S. Treasury Bonds, and obligations from various federal agencies including:

Federal Land Bank
Federal Home Loan Bank
Federal Farm Credit Bonds
Federal Credit Savings Bank
Farmers Home Administration Notes
World Bank Bonds
Bank for Cooperatives
Federal Home Loan Banks
Federal National Mortgage Association
Government National Mortgage Association

(Stipulation of Facts, paragraphs 3 and 5.)

4. Pursuant to statute, the measure of the tax paid by these banks did not include interest income earned by the banks on State

University Board Bonds (SUB's) and Industrial Development Bonds (IDB's) issued by municipalities in the State of Minnesota. (Stipulation of Facts, paragraph 4.)

5. Also exempted from inclusion in the measure of the state bank taxes paid by the plaintiffs was interest earned on the following obligations of agencies of the State of Minnesota:

Minnesota Higher Education Coordinating Board Bonds
Minnesota Higher Education Facilities Authority Bonds
Metropolitan Transit Commission Bonds
Public Water and Sewer Bonds
Hospital District Bonds
Hospital Revenue Bonds
St. Cloud Transit Commission Bonds
Metropolitan Waste Control Commission Bonds
Housing Redevelopment Authority Bonds
Area Redevelopment Agency Bonds
Minnesota State Armory Commission Bonds
Solid Waste Management District Bonds

6. The Plaintiffs filed timely protective claims for refunds for the tax year 1979. (Stipulation of Facts, paragraph 2.)

7. The plaintiffs in both of these consolidated actions timely filed these actions for refunds.

8. There is no economic difference between the Minnesota bank tax imposed by Minn. Stat. § 290.361, which is labelled an "excise" tax measured by net income, and a tax that is imposed directly on net income such as the federal income tax.

INITIAL CONCLUSIONS OF LAW

9. During the 1979 through 1983 calendar years, the imposition of the Minnesota bank tax, pursuant to Minn. Stat. § 290.361, on interest received or accrued from obligations of the United States and its agencies was discriminatory because interest

received or accrued from certain obligations of the State of Minnesota, its political subdivisions, and its instrumentalities was exempt from the tax. Cf. Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 74 L. Ed. 2d 562, 103 S. Ct. 692 (1983).

10. Inasmuch as the Minnesota bank tax was discriminatory during the 1979 through 1983 calendar years, it was unlawful under the provisions of 31 U.S.C. § 742 (currently codified at 31 U.S.C. § 3124(a)) and under the Supremacy and Borrowing Clauses of the United States Constitution. Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 74 L. Ed. 2d 562, 103 S. Ct. 692 (1983).

11. The Minnesota bank tax imposed by Minn. Stat. § 290.361, although labelled an "excise" tax, is a direct tax on net income for purposes of federal statutory and constitutional law. Cf. Complete Auto Transit v. Brady, 430 U.S. 274, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977) (the constitutionality of a state tax depends upon its actual economic consequences, not upon the label given to it by the state).

12. Inasmuch as the Minnesota bank tax is an income tax rather than a franchise tax, it was unlawful under the provisions of 31 U.S.C. § 742 (currently codified at 31 U.S.C. § 3124(a)) and under the Supremacy and Borrowing Clauses of the United States Constitution during the 1979 through 1983 calendar years. Cf. Federal Products Corp. v. Norberg, 429 A.2d 447 (R.I. 1981).

13. Defendants are liable to plaintiffs for refunds attributable to Minnesota bank taxes paid with respect to interest received or accrued on obligations of the United States and its agencies in amounts to be determined in a separate trials on the issue of damages.

BACKGROUND TO ADDITIONAL FINDINGS OF FACT AND CONCLUSION OF LAW

The State of Minnesota acknowledges that Minnesota's

bank tax treats interest earned on certain state obligations more favorably than it does interest earned on federal obligations. Nevertheless, the state argues that the tax is not unconstitutional. It presents three arguments in support of its position. The first is that the state obligations given preferential treatment under the state tax are not sufficiently "comparable" to federal obligations to establish discrimination. Second, the state argues that the preferential treatment of certain state obligations has little or no effect on the cost of borrowing by the federal government and, consequently, the preferential treatment is of no legal consequence. Finally, the state argues that the plaintiff banks are estopped from making these claims because they received the benefits of the provision they now claim to be unconstitutional. These defenses are referred to as the "comparability," "de minimis impact," and "estoppel" defenses.

As mentioned previously the plaintiffs moved at the inception of the trial for a ruling as a matter of law that none of these three defenses was legally cognizable. The Court denied those motions prior to trial and allowed the defendant to present testimony in support of these defenses. The Court felt that this case would be more appropriately structured for review by an appellate tribunal if these three defenses would receive a full and complete hearing. Based on all of the evidence presented by both sides, the Court makes the following additional Findings of Fact and Conclusions of Law.

ADDITIONAL FINDINGS OF FACTS CONCERNING THE AFFIRMATIVE DEFENSES

A. "Comparability."

14. The obligations of the federal government and the exempted state obligations (See Findings 3 and 4 above) are similar in that they all are:

(a) Debt instruments (Tr. Vol. I at 48.)

(b) With fixed periods of repayment. Id.

(c) With fixed interest rates. Id. at 47

(d) With the payor of the obligation identified in the instrument. Id.

(e) With the principal amount of the debt fixed. Id.

(f) With the right in the bearer to resell them. Id. at 47.

(g) Issued by governmental agencies. Id.

(h) Issued pursuant to and in compliance with specific statutory authorization. Id.

(i) And, in the case of Federal Farm Credit Obligation and IDB's, both are used to provide low cost financing for statutorily approved purposes and both depend on repayment of debts by the beneficiary of the low cost financing. (Tr. Vol. I at 91-92.)

15. State obligations, including some IDB's, compete with some treasury obligations for investor dollars. (Tr. Vol. I at 46-47.)

16. Investors in debt instruments compare many different characteristics of those instruments in making their investment choices. (Tr. Vol. I at 46 and 48.) Among those are the characteristics of risk and liquidity. Id.

17. Obligations of the United States Treasury are generally considered to be of low risk and high liquidity. (See Defendants' Exhibit 1.)

18. Some IDB's are likewise considered to be of low risk and high liquidity. Indeed, some IDB's are perceived as being less risky and as liquid as certain of the non-treasury obligations of the federal government. (Tr. Vol. I at 63-66 and 70.)

19. Differences in risk, as well as in other characteristics, tend to be reflected in the prices of a bond. (Tr. Vol. I at 61.) The issuers of bonds which may be perceived as risky tend to offer higher interest rates than do issuers of bonds of less risk and greater

liquidity. Id. This price adjustment allows for competitive comparisons of obligations with different characteristics.

20. To the extent that the obligations of the State of Tennessee and its political subdivisions are comparable to federal obligations, Minnesota Obligations are likewise comparable. (See Plaintiffs' Exhibit 2, attachments N and P.)

B. "De Minimis Impact."

21. The exemption granted to certain state obligations under the Minnesota Bank Tax caused the interest rate for those obligations to be lower than they would have been without the exemption. [Plaintiffs' Exhibit 6, at 8 (Nantell), Tr. Vol. II at 10 (Sohn), Tr. Vol. III at 153 (Kareken).] Investors who are interested in after tax return can get a competitive return on bonds bearing lower interest if they are also granted a tax exemption on the interest earned from those bonds. [Tr. Vol. II at 14, 30-31 (Sohn), Tr. Vol. IV at 7 (Kareken), Tr. Vol. V at 37-38 (Wyss).]

22. Because the tax exemption allows these obligations to carry lower interest rates, the demand for this type of credit among borrowers was higher than it would have been without the exemption. Id.

23. This phenomenon alone increases the interest rates on certain federal obligations. [Tr. Vol. IV at 17-19 (Kareken), Tr. Vol. V at 16-18 (Wyss).]

24. Moreover, the evidence established that as a result of lower interest rates on the tax exempt bonds there was a net increase in the amount of borrowing over that which would have existed without the exemption. [Tr. Vol. II at 17 (Sohn) and, e.g., Tr. Vol. V at 31 (Wyss).] This is pictorially represented on the supply/demand curves introduced at trial. (See e.g. Plaintiffs' Exhibit 7.)

25. The net increase in borrowing caused by the tax exemptions at issue here increased the competition among all

borrowers, raising the cost to all borrowers, including the federal government. [Tr. Vol. II at 17 (Sohn), Tr. Vol. V at 33-35 (Wyss).]

26. Credible testimony established that the tax exemption under consideration here resulted in additional credit demands for IDB's of approximately thirty percent (30%) for general development bonds and up to eighty percent (80%) for pollution control and nonprofit IDB's. (See Plaintiffs' Exhibit 17 at 2-4.) On a national basis, the thirty percent (30%) additionality for industrial bonds translates to an additional $6 billion of credit demand annually. [Tr. Vol. V at 33-34 (Wyss).] The result of such an addition to the competition for credit on the federal government would be to increase federal borrowing costs approximately $1.75 billion. [Tr. Vol. V at 35 (Wyss).]

27. The preferential treatment by the state of various of its obligations burdened the holders of federal obligations. The result was that the cost of borrowing by the federal government was higher than it would have been without the preferential treatment. [Tr. Vol. II at 12 and 17 (Sohn), Tr. Vol. III at 159 (Kareken), and Tr. Vol. V at 37-44 (Wyss).]

C. "ESTOPPEL."

28. The plaintiffs, by availing themselves of the tax exemption granted by the state on certain of its obligations, did not claim any benefits under the portion of the tax code asserted by plaintiffs to have been unconstitutional.

ADDITIONAL CONCLUSIONS OF LAW CONCERNING THE AFFIRMATIVE DEFENSES

A. "Comparability."

29. This Court concludes as a matter of law that the state obligations which received preferential treatment by the State of Minnesota are, for the purposes of the constitutional and statutory

analysis required under Memphis Bank, otherwise comparable to federal obligations.

B. "DE MINIMIS IMPACT"

30. This court further concludes that preferential treatment of state obligations is, on its face, discrimination. It would be of no legal significance had the state succeeded in establishing that the economic incident of that discrimination was minute or even nonexistent. To protect the constitutional principle at issue, it is enough that there be facial discrimination.

31. Moreover, the evidence clearly established that the discriminatory taxing scheme used by the State of Minnesota, if likewise used by all fifty states, would cause the interest rates paid by the federal government in support of its debt to rise. The economic incidence of this discrimination would be far from de minimis, reaching into the billions of dollars of increased federal expense.

C. "The Estoppel Defense."

32. The plaintiffs are not estopped from bringing this claim for refund. The theory of estoppel upon which the defendant relies is no longer the law in the State of Minnesota. See Wegan v. Village of Lexington, 309 N.W.2d 273, 277 (Minn. 1981); Haugen v. Town of Walthen, 292 N.W.2d 373 (Minn. 1980); Werner v. Olmstead County, 290 N.W.2d 444 (Minn. 1980). Moreover, factually the theory is simply inapplicable since plaintiffs did not benefit from the provisions they claim are unconstitutional.

33. All of the foregoing Findings of Fact may, if deemed more appropriate, be considered Conclusions of Law and vice versa.

* * *

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that the defendants are adjudged liable to the plaintiffs for tax refunds in amounts to be determined in Phase II of this proceeding.

Dated at St. Paul, Minnesota, this 20th day of May, 1987.

S/Harold W. Schultz

HAROLD W. SCHULTZ
JUDGE OF THE DISTRICT COURT

MEMORANDUM

This Court feels that an extensive memorandum quoting cases, statutes, etc., is unnecessary. The attorneys involved in this case did an exceptionally able job of preparing and presenting this case.

First of all, counsel had stipulated as to certain facts, had taken depositions, and had briefed the various issues to a point where the trial went exceptionally smooth.

Counsel presented to the Court motions which, as far as the plaintiffs were concerned, would have disposed of the case much in the manner of a summary judgment. While the arguments on the part of plaintiffs were reasonably persuasive, the Court felt that there was a danger that if the case were disposed of on that basis it could be suggested that ample opportunity to raise factual issues and defenses had not been given to the defendants. Therefore, the Court denied the motions for summary judgment and granted the defendants' motions for a hearing on the various items that defendants felt were proper defenses to plaintiffs' claims. A substantial amount of time was given to the defendants to present the testimony of experts dealing with the questions of comparability

and de minimis impact.

The argument with respect to the estoppel agreement was a legal argument not requiring any testimony.

The testimony of the expert witnesses was produced and heard by the Court in an expeditious manner. However, a complete hearing was given to the defendants with respect to these issues. Unfortunately, neither the testimony of the witnesses nor the law provide any comfort to the position taken by the defendants. This Court was convinced beyond any doubt that the plaintiffs must prevail in this matter.

A careful reading of the Supreme Court with respect to the Memphis Bank and Trust Company case leads the Court to the conclusion that the Minnesota and Tennessee situations for all practical purposes are identical. The burden of proof which the state had with respect to the comparability defense was not met and the Court has concluded that on that defense the state does not prevail.

The Court further adopts the position taken by plaintiffs that the important aspect for the Court in this matter was discrimination rather than impact. It goes without saying that the Court found discrimination and sufficient impact. The state did not establish that the effect of its discriminatory tax had only a de minimis impact.

It should be noted that counsel have suggested that the policy questions and the complexity of the issues herein dictate that this matter be reviewed by the appellate system in the State of Minnesota and possibly even in the federal courts. For that reason the Court feels that the record provides an ample basis for any appellate review.

The Court feels that it would be redundant to restate the facts as set out in the Findings of Fact, Conclusions of Law, and Order. This matter has been well tried, carefully considered, and the conclusion as stated in the Court's order is, in the opinion of the

Court, the only conclusion possible based on the facts and the law.

S/Schultz, J.

Schultz, J.

CASE TYPE: OTHER CIVIL

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN SECOND JUDICIAL DISTRICT

Cambridge State Bank, et al.,

Plaintiffs,

vs. File No. C1 84 469151

Arthur C. Roemer, Commissioner, Department of Revenue, State of Minnesota,

Defendant.

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Plaintiff,

vs. File No. C4 84 469547

Arthur C. Roemer, in his capacity as Commissioner of Revenue, and the State of Minnesota,

Defendants.

FINDINGS OF FACT,
CONCLUSIONS OF LAW,
AND ORDER ON PHASE II - REFUNDS

These consolidated cases came on for trial before The Honorable Harold W. Schultz, Judge of the District Court, on February 27 and 28, 1989, in Courtroom 1531, Ramsey County Courthouse, St. Paul, Minnesota.

ROBERT L. SCHNELL, JR., ESQ., of the law firm FAEGRE & BENSON, 2200 Norwest Center, Minneapolis, Minnesota 55402, and WALTER A. PICKHARDT, ESQ., of the law firm of FAEGRE & BENSON, Suite 1150, 8400 Tower, 8400 Normandale Lake Boulevard, Bloomington, Minnesota 55437-1076, appeared representing Plaintiff Norwest Bank Duluth.

ANDREW J. MITCHELL, ESQ., of the law firm of LARKIN, HOFFMAN, DALY & LINDGREN, LTD., 1500 Northwestern Financial Center, 7900 Xerxes Avenue South, Bloomington, Minnesota 55431, appeared representing Plaintiffs Cambridge State Bank, et al.

THOMAS L. FABEL, ESQ., of the law firm of LINDQUIST & VENNUM, 4200 IDS Center, Minneapolis, Minnesota 55402, appeared representing Plaintiffs Cambridge State Bank, et al.

THOMAS R. MUCK, ESQ., Deputy Attorney General, and BARRY GRELLER, ESQ., Special Assistant Attorney General, Tax Litigation Division, 10 River Park Plaza, Mail Station 0600, St. Paul, Minnesota 55146, appeared representing the Defendants.

By agreement of counsel and order of this Court, this case was bifurcated into separate trials on the issues of liability and damages. In Phase I of the case, the Court held that the Minnesota bank tax (Minn. Stat. §290.361) unlawfully discriminated against Federal obligations during the period 1979 through 1983 in violation of Federal law, 31 U.S.C. §742. The Court also held that the Minnesota bank tax, although labelled an "excise" tax, was an

income tax for purposes of Federal statutory and constitutional law, and that this also made the Minnesota bank tax unlawful under 31 U.S.C. §742. The Court held that Defendants were liable to Plaintiffs for refunds in amounts to be determined at Phase II of the trial. These Findings and Conclusions concern Phase II, the refund portion of the trial.

By further agreement of counsel and order of this Court, the matter was presented on a test case basis. Evidence was presented by four banks (the "Test Banks") for the 1979 tax year. The four banks were: Cambridge State Bank ("Cambridge"), Midway National Bank of St. Paul ("Midway"), First Security State Bank of Sleepy Eye ("Sleepy Eye"), and Norwest Bank Duluth ("Norwest"). The parties agreed that the conclusion of the Court on the refund phase would be conclusive as to all tax years at issue and all of the Plaintiff banks.

Prior to the commencement of trial, the parties submitted motions in limine. The Plaintiffs moved for summary judgment on certain issues or, in the alternative, for an order to exclude certain evidence as irrelevant. The Defendants also submitted motions for summary judgment. The Court heard arguments regarding all motions on January 20, 1989.

Plaintiffs' first motion requested partial summary judgment dismissing Defendants' contention that discrimination against Federal obligations should be cured by invalidating all statutes favoring state bonds. Defendants' second motion requested summary judgment in favor of invalidating such statutes, which would result in the removal of the tax-exempt status of such bonds. At the commencement of trial, the Court granted Plaintiffs' first motion and denied Defendants' second motion. A Conclusion of Law to this effect is included below in paragraph 31. The Court held that discrimination against Federal obligations would not be cured by retroactively invalidating the tax-exempt status of state bonds because, in actual fact, such bonds were tax-exempt in 1979

and the Department of Revenue has not collected (and by stipulation will not collect) tax on such bonds. Thus, granting Defendants' second motion would, in substance and effect, uphold the unconstitutional discrimination against Federal obligations and deny Plaintiffs a remedy.

Plaintiffs' second motion requested partial summary judgment dismissing the contention of Defendants' that Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), be applied on a prospective-only basis. In the alternative, Plaintiffs' moved for the exclusion of the testimony of Mr. Oja Ena with respect to the prospectivity issue. This latter motion was denied, and Mr. Ena's testimony was received. Defendants' third motion requested summary judgment that the Memphis Bank case should be applied on a prospective-only basis. Defendants also moved in their first motion for summary judgment that the Court's ruling holding the Minnesota bank to be an income tax should be applied on a prospective-only basis. Having received the testimony of Mr. Ena on these issues, the Court hereby denies all motions on prospectivity issues, which instead will be considered upon all of the evidence received.

Plaintiffs' third motion asked for summary judgment that their interest deductions should be allowed as a matter of law pursuant to Minn. Stat. §290.09, subd. 3. Defendants filed a cross-motion for summary judgment on this issue. Plaintiffs, as an alternative, requested that the testimony of Mr. Larry D. Fredricks, a witness for Defendants, be excluded. The Court denied this latter motion and received the testimony of Mr. Fredricks. The Court also received the testimony of Plaintiffs' witnesses, Mr. Philip D. Rolle and Mr. Lloyd A. Amundson, on this issue. Inasmuch as both parties have introduced testimony on the issue of whether interest deductions should be disallowed, the Court hereby denies all motions on this issue, which will instead be considered upon all of the evidence received.

At the inception of the trial of Phase II, the parties submitted a Statement of Position and Stipulation of Facts (Phase II) and attached exhibits (Plaintiffs' Exhibit 21) which were received into evidence. Thereafter, the Plaintiffs called as witnesses Mr. Rolle and Mr. Amundson, who testified regarding the investment activities, operations and expenses of banks. Defendants called Mr. Fredricks, who testified regarding the same issues, and Mr. Ena, who testified regarding the financial impact to the State of Minnesota in the event refunds are awarded to all taxpayers who have relied on the Memphis Bank case in filing refund claims. The trial then concluded.

Having heard the testimony presented, and upon all of the evidence, files, records, and proceedings herein, the Court makes the following Findings of Fact, Conclusions of Law, and Orders.

FINDINGS OF FACT

1. Several of the findings of fact that follow are summaries of facts detailed in the Statement of Position and Stipulation of Facts (Phase II) dated February 27, 1989 (the "Phase II Stipulation"), and exhibits thereto (See Plaintiffs' Exhibit 21). All of the facts stipulated to in the Phase II Stipulation are explicitly found to be facts by this Court, and are incorporated by reference, although they will not be recited individually here.

2. The Test Banks paid Minnesota bank taxes for 1979 in the following amounts: Northwest, $229,295 (Phase II Stipulation, ¶ 28); Sleepy Eye, $36,378.36 (Phase II Stipulation, ¶ 33); Cambridge, $23,933 (Phase II Stipulation, ¶ 38); Midway, $293,840 (Phase II Stipulation, ¶ 43).

3. The items of income, deduction and credit reported by each Test Bank on its Minnesota bank tax return for 1979 were accurate in amount. Such items were also properly reported for Minnesota bank tax purposes, except that (a) each Test Bank

reported as taxable income interest earned on Federal obligations, which was held exempt from tax in Phase I of this case, and (b) because such interest was held to be exempt, certain deductions previously allowable became disallowable, as hereinafter described. (Phase II Stipulation, ¶'s 30, 35, 40 and 45.)

4. The Test Banks earned interest on Federal obligations in 1979 in the following amounts: Norwest, $1,599,288 (Phase II Stipulation, ¶ 30); Sleepy Eye, $348,577 (Phase II Stipulation, ¶ 35); Cambridge, $612,697 (Phase II Stipulation, ¶ 40); Midway, $393,125 (Phase II Stipulation, ¶ 45).

5. The Test Banks incurred investment operating expenses in 1979, which consisted of operating expenses associated with Test Bank investment functions insofar as they were allocable to Federal obligations. Investment operating expenses included salaries and fringe benefits paid during the 1979 taxable year to employees whose duties included investing in Federal obligations and monitoring such investments, and certain other expenses relating thereto, including: expenses for management fees, office supplies, postage, telephone, data processing and occupancy, as well as depreciation on furniture and equipment used by personnel performing the investment function. (Phase II Stipulation, ¶ 10.C.)

6. The Test Banks incurred investment operating expenses in 1979 in the following amounts: Norwest, $23,744; Sleepy Eye, $7,395; Cambridge, $12,318; and Midway, $5,009. (Phase II Stipulation, ¶ 10.D.) The Test Banks deducted such investment operating expenses in computing their respective liability for Minnesota bank tax.

7. There was a direct relationship between investment operating expenses and investment transactions. As the number of investment transactions increased or decreased, investment operating expenses increased or decreased. The reason for this is that there was a tie-in between investment operating expenses, which represent the cost of actually making investments, and investment transac-

tions. (Tr. Vol. I at 63-66 [Rolle].)

8. Investment operating expenses incurred and deducted by the Test Banks were connected with or allocable against interest earned on Federal obligations. (Phase II Stipulation, ¶ 10.B; Tr. Vol. I at 63 [Rolle]; Tr. Vol. I at 176-180 [Amundson].)

9. Banks have a legal obligation under their charters to accept deposits. (Tr. Vol. I at 66 [Rolle]; Tr. Vol. I. at 187-88 [Amundson].) Banks can indirectly affect the amount of funds deposited by customers by setting interest rates paid on deposits and by advertising. However, banks cannot control the amount of deposits. (Tr. Vol. I at 67-72 and 115 [Rolle].)

10. Banks have a legal obligation under their charters and the Community Reinvestment Act to make loans. (Tr. Vol. I at 66 [Rolle]; Tr. Vol. I at 187-188 [Amundson].) Banks can indirectly affect the demand for loans by setting interest rates charged on loans and by advertising. However, banks cannot control the demand for loans by credit-worthy borrowers. (Tr. Vol. I at 72-76 and 115-116 [Rolle].)

11. If a bank does not have sufficient demand for loans, it may attempt to discourage a customer from depositing funds by suggesting that the customer purchase a Federal obligation, which can be sold to the customer by the bank. (Tr. Vol. I at 87-88 [Rolle].)

12. If a bank has deposits in excess of loans, because of an insufficiency in loan demand, the bank may "warehouse" its excess funds. In other words, it may invest its excess funds until an opportunity to lend the funds arises. Banks sometimes "warehouse" excess funds by purchasing Federal obligations. (Tr. Vol. I at 76-79 and 116 [Rolle]; Tr. Vol. I at 191-192 [Amundson].)

13. Banks do not accept deposits for the purpose of warehousing funds. (Tr. Vol. I at 129 [Rolle]; Tr. Vol. I at 192 [Amundson].)

14. Banks sometimes use Federal obligations to provide

liquidity. (Tr. Vol. I at 138-139 [Rolle]; Tr. Vol. I at 188 [Amundson].) However, they are not obligated to use Federal obligations to provide liquidity and commonly use other kinds of securities for this purpose. (Tr. Vol. I at 139-140 [Rolle].)

15. Banks do not accept deposits for the purpose of creating liquidity through the purchase of Federal obligations. (Tr. Vol. I at 189 [Amundson].)

16. Banks sometimes use Federal obligations to meet pledging requirements if a state or local government deposits funds in excess of $100,000. (Tr. Vol. I at 189-190 [Amundson].)

17. Banks do not accept deposits requiring pledged assets for the purpose of purchasing Federal obligations. (Tr. Vol. I at 190 [Amundson].)

18. Each of the Test Banks incurred (and deducted for Minnesota bank tax purposes) cost-of-money operating expenses in 1979. Cost-of-money operating expenses included salaries and fringe benefits paid to employees engaged in the fund-providing functions of a bank (i.e., those functions by which deposits and other funds are brought into a bank), including bank tellers, employees in checking operations, and employees engaged in acquiring equity capital and funds through long-term debt. Cost-of-money operating expenses also included expenses for office supplies, postage, telephone, advertising, travel, data processing and equipment and certain other expenses, all to the extent allocable to fund-providing functions. (Phase II Stipulation, ¶ 11.A.)

19. There was no relationship between cost-of-money operating expenses of the Test Banks and interest they earned on Federal obligations. For example, cost-of-money operating expenses of a bank might increase while its interest income from Federal obligations decreased, or vice versa. Increases and decreases in cost-of-money operating expenses occurred independently of increases and decreases in income from Federal obligations. (Tr. Vol. I at 79-83 and 116-117 [Rolle]; Tr. Vol. I at 182-

185 [Amundson].)

20. Cost-of-money operating expenses incurred and deducted by the Test Banks were not connected with or allocable against interest earned on Federal obligations. (Tr. Vol. I at 60-61 [Rolle]; Tr. Vol. I at 182 and 198 [Amundson].)

21. Each of the Test Banks incurred and deducted interest expense in 1979. (Phase II Stipulation, ¶'s 12-15.)

22. With the exception of interest paid by Norwest and Cambridge on capital notes, all interest deducted by the Test Banks was paid or accrued on short-term borrowings incurred by the Test Banks in the ordinary course of their banking business including: savings accounts, savings certificates, certificates of deposit, Federal funds purchased, repurchase agreements and Federal Reserve Bank borrowings. (Phase II Stipulation, ¶ 21.)

23. The borrowings described in paragraph 22 were incurred for the purpose of making loans. (Tr. Vol. I at 104 [Rolle]; Tr. Vol. I at 206 [Amundson].)

24. Norwest and Cambridge incurred interest expense on capital notes in 1979. The capital notes were issued for the purpose of increasing their capital and expanding their capacity to make loans. (Phase II Stipulation, ¶ 23.)

25. There was no direct connection between indebtedness incurred by a Test Bank and investments by a Test Bank in Federal obligations. (Phase II Stipulation, ¶ 24.)

26. There was no relationship between interest expense paid or accrued by the Test Banks and interest income earned by the Test Banks on Federal obligations. For example, interest expense of a bank might increase while its interest income from Federal obligations decreased, or vice versa. Increases and decreases in cost-of-money operating expenses occurred independently of increases and decreases in income from Federal obligations. (Tr. Vol. I at 83-86 [Rolle]; Tr. Vol. I at 186 [Amundson].)

27. The Test Banks did not incur or continue any indebted-

ness for the purpose of purchasing or carrying Federal obligations. (Tr. Vol. I at 62 [Rolle]; Tr. Vol. I at 186 [Amundson].)

28. The amount of refunds payable by the State of Minnesota to all taxpayers having claims similar to the Test Banks is speculative and has not been established.

29. Projections as of November, 1988, by the Minnesota Department of Finance establish that at June 30, 1989, which is the end of the current biennium, and through June 30, 1991, which is the end of the next biennium, the State of Minnesota will have sufficient funds in reserve to pay even the highest amount of refunds that might be due to all taxpayers as a result of this case. (Phase II Stipulation, Exhibit W, pages 24-26.)

30. For all tax years at issue through June 30, 1983, the Minnesota Department of Revenue did not collect, and has stipulated that it will not collect, Minnesota Bank taxes on interest earned from State University Board Bonds issued pursuant to Minn. Stat. § 136.31-38, or from Industrial Revenue Bonds issued prior to July 1, 1979, pursuant to Chapter 474 of the Minnesota Statutes, which was claimed as exempt income. (Phase II Stipulation, ¶ 58.)

CONCLUSIONS OF LAW

31. Unlawful discrimination by the State of Minnesota against Federal obligations cannot be cured by invalidating Minnesota Statutes favoring exempt State University Board Bonds, Industrial Revenue Bonds, or other exempt bonds.

32. This Court concludes that such unlawful discrimination must be cured by striking out language from Minnesota Statutes that caused Federal obligations to be taxed. Accordingly, it is held that Subdivision 13 of Section 290.08 of Minnesota Statutes shall read as follows for the period 1979 through June 30, 1983, with the stricken language severed from the statute:

Subd. 13. Certain exemptions inapplicable to

corporations. Subdivisions 4, 5, 10 and 11 shall not apply to corporations and subdivisions 7 ~~and 8~~ shall not apply to corporations taxable under section 290.02 or under section 290.361.

33. The decision of the United States Supreme Court in Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), was decided "under the principles established in [its] previous cases," as the Supreme Court stated in its opinion. 459 U.S. at 398. The Supreme Court did not establish a new principle of law in Memphis Bank.

34. Under principles set forth in Chevron Oil Co. v. Huson, 404 U.S. 97 (1971), because the Memphis Bank case did not establish a new principle of law, Memphis Bank applies retroactively to the years at issue in this case.

35. The "new principle of law" test set forth in Chevron is a threshold test. Since Memphis Bank did not establish a new principle of law, it is unnecessary to apply to second and third Chevron tests. However, if it were necessary, the Court would hold that (a) the purpose and effect of Memphis Bank would best be served by retroactive application, and (b) retroactive application of Memphis Bank would not cause an inequitable result.

36. The Court also holds that Memphis Bank should be applied retroactively because the United States Supreme Court did not limit the effect of its decision to prospective-only application. Cf. Welyczko v. U.S. Air, Inc., 733 F.2d 239 (2d Cir.), cert. denied, 469 U.S. 1036 (1984); U.S. v. Fitzgerald, 545 F.2d 578 (7th Cir. 1976).

37. This Court's holdings in Phase I of the case that the Minnesota bank tax was discriminatory and unlawful (Findings of Fact, Conclusions of Law, and Order on Phase I Liability, ¶'s 9 and 10), for which Memphis Bank is cited as authority, are also supported and compelled by the holding of the Minnesota Supreme Court in State v. Duluth M. & N. Ry Co., 207 Minn. 618, 292

N.W. 401 (1939), reh'g denied, 292 N.W. 411 (1940), cert. denied, 311 U.S. 719 (1940).

38. This Court's holdings in Phase I of the case that the Minnesota bank tax was an income tax for purposes of federal statutory and constitutional law, and was therefore unlawful (Findings of Fact, Conclusions of Law, and Order on Phase I Liability, ¶'s 11 and 12), was foreshadowed by Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), reh'g denied, 430 U.S. 976 (1977). These holdings did not establish a new principle of law. Accordingly, under Chevron, these holdings apply retroactively to the years at issue in this case.

39. Since this Court's holdings that the Minnesota bank tax is an income tax did not establish a new principle of law, it is unnecessary to apply the second and third Chevron tests. However, if it were necessary, the Court would hold that (a) the purpose and effect of the income tax holdings would best be served by retroactive application, and (b) retroactive application of the income tax rulings would not cause an inequitable result.

40. The Test Banks are entitled to refunds of Minnesota bank taxes for the 1979 test year.

41. In computing refunds due the Test Banks, interest earned on Federal obligations (see paragraph 4, supra) should be excluded from income. Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983); State v. Duluth M. & N. Ry. Co., 207 Minn. 618, 292 N.W. 401 (1939), reh'g denied, 292 N.W. 411 (1940), cert. denied, 311 U.S. 719 (1940); 31 U.S.C. §742.

42. In computing refunds due the Test Banks, investment operating expenses deducted by the Test Banks (see paragraph 6, supra) should be added back to income. Investment operating expenses were connected with and allocable against Federal obligation interest income, and are thus disallowed as deductions pursuant to Minn. Stat. § 290.10(9).

43. Because cost-of-money operating expenses were not

connected with or allocable against interest earned on Federal obligations, the Test Banks' cost-of-money operating expense deductions are not subject to disallowance under Minn. Stat. § 290.10(9).

44. The Court agrees with the parties that interest expense is connected with or allocable against Federal obligation interest (and that an interest deduction should be disallowed) only if the interest expense is paid or accrued on indebtedness incurred or continued to purchase or carry Federal obligations. (Phase II Stipulation, ¶ 26.C.)

45. Because the Test Banks did not incur or continue indebtedness to purchase or carry Federal obligations, the Test Banks' interest expense deductions are not subject to disallowance under Minn. Stat. § 290.09, Subd. 3, or Minn. Stat. § 290.10(9). Cf. Rev. Proc. 70-20, 1970-2 Cum. Bull. 499; Rev. Rul. 61-62, 1961-2 Cum. Bull. 58; I.T. 2028, III-1 Cum. Bull. 296 (1924).

46. The Court agrees with the computations of refunds submitted by the Test Banks as set forth in Exhibits F, H, J and L to the Phase II Stipulation.

47. This matter was presented on a test-case basis. The Norwest Bank Duluth lawsuit encompassed only tax year 1979. The Cambridge State Bank lawsuit involved numerous banks and tax years 1979 through 1983. Since the parties agreed that the conclusion of the Court would be conclusive as to all tax years at issue and all of Plaintiff Test Banks, there is no just reason for delay of entry of judgment as to the tax refunds due for tax year 1979 to Cambridge, Midway and Sleepy Eye.

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that Defendants are adjudged liable to the Plaintiff Test Banks for tax refunds in the following amounts: Norwest, $189,065; Sleepy Eye,

$36,278; Cambridge, $23,833; Midway, $46,574. The Court orders further that interest be paid upon these amounts as required by law.

The Court further finds that there is no just reason for delay in entry of final judgment with respect to the tax refunds for tax year 1979 for Norwest, Cambridge, Midway and Sleepy Eye. Accordingly, the Court expressly directs that judgment be entered immediately in accordance with this Order.

Dated at St. Paul, Minnesota, this _____ day of _____, 1989.

_____

HAROLD W. SCHULTZ
JUDGE OF THE DISTRICT COURT

CASE TYPE: OTHER CIVIL

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN SECOND JUDICIAL DISTRICT

Cambridge State Bank, et. al.,

Plaintiffs,

vs. File No. C1 84 469151

Arthur C. Roemer, Commissioner, Department of Revenue, State of Minnesota,

Defendant.

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Plaintiff,

vs. File No. C4 84 469547

Arthur C. Roemer, in his capacity as Commissioner of Revenue, and the State of Minnesota,

Defendants.

MEMORANDUM

Phase II of the case before the Court was well prepared and tried by all counsel. The efforts on the part of counsel who tried to dispose of the matter by settlement are to be commended. However, because the matter could not be disposed of by settlement, it was necessary for the Court to hold the hearing and to rule on the issues in Phase II of this case. Primarily, the only issue before the Court was question of damages as far as all of the Plaintiffs are concerned and it should be kept in mind that this is considered a test case in a matter of speaking and, therefore, figures for some of the other Plaintiff banks will have to be determined by counsel.

The key issue as far as the Court is concerned in this matter was whether or not the principles of law announced in the Memphis Bank case should be applied on a prospective basis or a retrospective basis. This matter was vigorously contested and the Court has determined that based on all of the law and the facts at hand, the liability against the State of Minnesota in this matter is to be applied retrospectively. It should be noted that in the Memphis State Bank case, the Supreme Court of the United States did not declare its determination as to retroactivity or prospectivity. As a matter of fact, the federal judicial system has indicated that that question is one of public policy and is to be determined by the respective states. It does appear that if the United States Supreme Court wanted this matter to be handled only prospectively, it would have declared so in its opinion. And also it was declared in the case of Solum versus Stumer, 104 Supreme Court 1338, 1341 (1984) that prospectively is only an exception to the general rule of retroactivity. Counsel have indicated that there is no clear cut precedent here in the State of Minnesota with respect to this question. The Court agrees. The only instance that counsel and Court were able to find were a similar question where a similar

question was decided by one of our neighboring states, is the matter of the case of Burlington Northern, Inc., et al versus City of Superior, Wisconsin. This was in the Court of Appeals, District Three for the State of Wisconsin. And further inquiry has determined that the Supreme Court of the State of Wisconsin has refused to review the matter, so the determination of the Court of Appeals stands.

In this case, the question of retroactivity involves taxes paid by the Plaintiffs to the City was determined in favor of the Plaintiffs.

Now that the Court has concluded that the law is to be applied retroactively, the next question to be determined was whether or not certain deductions were to take place in calculating the refund. The Court did not rule on any of the motions made with respect to the problem and allowed the testimony of two witnesses for the Plaintiffs and two witnesses for the State to assist the Court in determining this matter. After hearing the testimony of all of the witnesses, the Court has determined that the Plaintiff's position in this matter is the correct one and must stand. No further purpose would be served by going into ancillary problems or to reiterate cases that stand as foundation for the Court's Finding of Fact and Conclusions of Law.

S/Harold W. Schultz

Harold W. Schultz
Judge of the District Court

STATE OF MINNESOTA **Supreme Court**

Cambridge State Bank, et. al.,
Respondents,
Norwest Bank Duluth, National Association (formerly First National Bank of Duluth,)
Respondent,

vs.
Arthur C. Roemer, Commissioner, Department of Revenue, and the State of Minnesota,
Appellants.

JUDGMENT

C0-89-2097
Appellate Court Case No.

C184469151
Trial Court Case No.

Pursuant to an order of Court heretofore duly made and entered in this cause it is determined and adjudged that the judgment of the Court below, herein appealed from, to wit, of the District Court within and for the County of Ramsey be and the same hereby is affirmed in part, reversed in part in accordance with the opinion and that judgment be entered accordingly. A certified copy of the entry of judgment and the Court's decision is herein transmitted and made part of the remittitur.

Dated and signed: FOR THE COURT 8-28-90
Dated

Attest: Frederick K. Grittner
Clerk of the Appellate Courts

By: S/J. Kurth
Assistant Clerk

Minn. Stat. § 290.08 (1978) (Denial of exemption from Minnesota bank excise tax for interest on federal obligations).

290.08 EXEMPTIONS FROM GROSS INCOME.

Subdivision 1. In general. The following items shall not be included in gross income, provided that any item which was excluded in arriving at gross income under the provisions of section 290.01, subdivision 20, shall not be again excluded under this section.

* * * *

Subd. 8. Interest from United States. Interest upon obligations of the United States, its possessions, its agencies, or its instrumentalities, so far as immune from state taxation under federal law . . .

* * * *

Subd.13. Certain exemptions inapplicable to corporations. . . . [S]ubdivisions 7 and 8 shall not apply to corporations taxable under section 290.02 or under section 290.361.

Minn. Stat. § 290.361 (1978) (Imposition of Minnesota bank excise tax).

290.361 NATIONAL AND STATE BANKS; IMPOSITION OF EXCISE TAX, COMPUTATION, SURTAX.

Subdivision 1. Imposition of excise tax. An excise tax measured by net income is hereby imposed on national and state banks by this chapter and shall be governed by the provisions of section 290.02.

* * * *

Subd 4. The revenues derived from the excise tax on banks shall be paid into the state treasury and credited to the general fund, from which shall be paid all refunds of taxes erroneously collected from banks as certified by the commissioner.

There is hereby appropriated to the persons or banks entitled to such refunds, from the general fund, an amount sufficient to make the refunds.

Minn. Stat. § 290.50 (1982 and Supp. 1983) (Refund procedures applicable to overpayments of Minnesota bank excise tax).

290.05 OVERPAYMENTS, CLAIMS FOR REFUND OR CREDITS.

Subdivision 1. Procedure, time limit. (a) A taxpayer who has paid or from whom there has been collected an amount of tax for any year in excess of the amount legally due for that year, may file with the commissioner a claim for a refund of such excess. Except as otherwise provided in this section, no claim or refund shall be allowed or made after three and one-half years from the date prescribed for filing the return (plus any extension of time granted for filing the return, but only if filed within the extended time) or after two years from the date of overpayment, whichever period is longer, unless before the expiration of the period a claim is filed by the taxpayer. For this purpose an income tax return or amended return claiming an overpayment shall constitute a claim for refund.

* * * *

Subd. 2. Denial of claim, court proceedings. If the claim is denied in whole or in part, the commissioner shall mail an order of denial to the taxpayer in the manner prescribed in section 290.46. An appeal from this order may be taken to the Minnesota tax court in the manner prescribed in section 271.06, or the taxpayer may commence an action against the commissioner to recover the denied overpayment. Such action may be brought in the district court of the district in which lies the county of his residence or principal place of business or if an estate or trust, of the principal place of its administration, or in the district court for Ramsey county. The action in the district court shall be commenced within 18 months following the mailing of the order of denial to the taxpayer. If a claim for refund is filed by a taxpayer and no order of denial is

issued within six months of the filing, the taxpayer may commence an action in the district court as in the case of a denial, but the action shall be commenced within two years of the date that the claim for refund was filed.

Minn. Stat. § 136.32 (1978) (Exemption from Minnesota bank excise tax for interest on State University Board Bonds).

136.32 BONDS, INVESTMENTS

. . . All bonds issued under sections 136.31 to 136.38 shall be exempt from all taxation. Interest paid on such bonds shall not be included in gross income for the purpose of computing any tax imposed by or under any provisions of chapter 290, or any act amendatory thereof or supplemental thereto.

Minn. Stat. § 474.12 (Supp. 1979) (Exemption from Minnesota bank excise tax for interest on Industrial Development Bonds).

474.12 EXCLUSION OF INTEREST ON BONDS FROM GROSS INCOME.

Subdivision 1. Interest paid on bonds issued under authority of this chapter shall not be included in gross income for the purpose of computing any tax imposed by or under the provisions of chapter 290, or any act amendatory thereof or supplemental thereto.

Subd. 2. Notwithstanding subdivision 1, the interest paid on bonds issued under authority of this chapter and issued after June 30, 1979 shall be exempt only as provided under section 290.08, subdivision 7, for obligations of the issuing municipality.

No. 90-645

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

NORWEST BANK DULUTH, N.A.,
Petitioner,

v.

MINNESOTA COMMISSIONER OF REVENUE and the STATE OF MINNESOTA,
Respondents.

CAMBRIDGE STATE BANK, *et al.*,
Petitioners,

v.

MINNESOTA COMMISSIONER OF REVENUE,
Respondent.

On Petition for Writ of Certiorari to the Minnesota Supreme Court

---

BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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On Petition for Writ of Certiorari to the Minnesota Supreme Court

---

BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation of the Council of State Chambers of Commerce as *amicus curiae* in support of the petitioners' petition for writ of certiorari in the above-captioned case. Written consents of the petitioners and respondents have been obtained and filed with the Clerk of this Court.

INTEREST OF *AMICUS CURIAE*

The Council of State Chambers of Commerce (Council), organized in 1932, consists of 43 state chambers of commerce. The Committee on State Taxation (COST), an advisory committee of the Council, consists of 360 corporate members. COST member corporations conduct a substantial portion of the interstate commerce in the United States. The members are representative of that part of the Nation's business sector which is most directly affected by the state taxation of interstate operations.

COST's objective is to preserve and promote equitable and non-discriminatory state and local taxation of corporations doing business in more than one taxing jurisdiction. This objective is accomplished, in part, through the promotion of procedural rights of taxpayers. These procedural rights assure taxpayers a full and fair opportunity to contest the legality of state taxes and to receive a meaningful remedy when state taxes are ultimately found to be illegal or unconstitutional. COST is, therefore, vitally interested in cases such as the instant case, in which the State of Minnesota has denied taxpayers a meaningful remedy from the State's levy of an unconstitutional tax.

SUMMARY OF ARGUMENT

The issue in this case is whether the Due Process Clause requires a State to refund taxes collected in violation of federal statutes and the intergovernmental tax immunity doctrine under the Supremacy Clause.

The taxpayers in this case challenged the Minnesota Bank Excise Tax, which included interest from federal obligations in the tax base, but excluded interest from certain state obligations. The tax at issue was virtually identical to that found unconstitutional in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983). The State conceded that the tax scheme discriminated against the

federal government. *Cambridge State Bank v. Roemer*, 457 N.W.2d 718 (1990), Appendix p. 7A. The Minnesota Supreme Court correctly found that Minnesota's tax scheme was a discriminatory franchise tax which violated 31 U.S.C. Sec. 3124; and that the tax scheme violated the intergovernmental tax immunity doctrine. However, the Court refused to remedy that discrimination, holding that the taxpayers were not entitled to a refund of the illegally collected tax. The effect of the decision was to sustain the tax for the tax period at issue despite the fact that neither the State nor the court questioned the violation of 31 U.S.C. Sec. 3124 for that period.

Unlike this Court's recent decisions in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S.Ct. 2238 (1990), *American Trucking Associations, Inc. v. Smith*, 110 S.Ct. 2323 (1990), *Ashland Oil, Inc. v. Caryl*, 110 S.Ct. 3202 (1990) and *National Mines Corp. v. Caryl*, 110 S.Ct. 3205 (1990), all of which involve the question of how a Commerce Clause ruling of this Court was to be applied, this case involves neither the Commerce Clause nor the question of how a decision of this Court is to be applied. Rather, this case involves a violation of a federal statute. The appropriate remedy for the harm caused by Minnesota's illegal tax is to refund the improperly imposed taxes to taxpayers who have followed the State's refund procedure. See, *Montana National Bank v. Yellowstone County*, 276 U.S. 499 (1928); *Ward v. Board of County Commissioners*, 253 U.S. 17 (1920); *Carpenter v. Shaw*, 280 U.S. 363 (1930).

The decision of the Minnesota Supreme Court is the first state court decision involving the retention of illegally collected taxes to be issued after this Court's decisions in *McKesson*, *supra*, and *American Trucking*, *supra*. The decision distinctly shows the confusion that still exists regarding what is required to provide a meaningful remedy when states refuse to refund unconstitutional

and illegal taxes. An even more fundamental flaw in the reasoning of the court below is that court's apparent confusion of the reasoning of *American Trucking*, which dealt with the prospective/retrospective application of a Commerce Clause decision of this Court, with *McKesson*, which dealt with the due process requirements that attend the determination of the appropriate remedy to be accorded the payor of a tax imposed in violation of federal law.

The decision and its inventive reasoning clearly show the lengths to which state courts will go in order to protect state treasuries. Rather than correctly analyze this case by determining what actions a State must take to remedy the imposition of a tax in violation of federal law, the Minnesota Court incorrectly chose to cast this case in terms of "prospectivity". As the Minnesota decision so clearly shows, this "prospectivity doctrine" can be turned and twisted in any way necessary to justify the result a court wishes to reach.

Moreover, the Minnesota Court determined that because the taxpayers filed their returns in compliance with State law and took advantage of exemptions available to them, they were allegedly estopped from claiming any remedy for the State's imposition of an illegal tax. The Court's acceptance of this argument does reflect a certain nimbleness of wit, but it shows a total disregard for precedent. See, *Montana National Bank*, *supra*. And its effective approval of the tax scheme for the tax period in issue reflects a total disregard for the federal statute involved. It is imperative that this Court clarify the constitutional remedial requirements that bind the state courts and that it show that, until the state courts follow those mandates, this Court will act to protect the rights of taxpayers.

ARGUMENT

A STATE MUST REFUND ILLEGAL TAXES COLLECTED IN VIOLATION OF THE SUPREMACY CLAUSE

It is agreed in this case that Minnesota's Bank Excise Tax discriminated against the federal government in that the tax included in its base interest from federal obligations while exempting the interest from certain state obligations. Thus, the tax violated 31 U.S.C. Sec. 3124 and violated the intergovernmental tax immunity doctrine, thereby contravening the Supremacy Clause of the United States Constitution. Consequently, the only issue before this Court is whether a State, in refusing to provide a remedy for its imposition of a tax in violation of federal law, has violated the Due Process Clause.

By including the interest from federal obligations in its tax base, the State of Minnesota attempted to tax income that under the Constitution and federal law are exempt from state taxation. *Phillips Chemical Co. v. Dumas School District*, 361 U.S. 376 (1960). A tax which unconstitutionally discriminates against the federal government is void and may not be exacted. *Moses Lake Homes v. Grant County*, 365 U.S. 744, 752 (1961). As this Court noted, when a State attempts to impose a tax which is beyond the State's power to impose "[t]he State would have had no choice but to 'undo' the unlawful deprivation by refunding the tax previously paid. . .". *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S.Ct. 2238, 2251 (1990).

McKesson and the cases discussed therein make clear that due process requires that a state provide a clear and certain remedy where it has exacted an illegal or unconstitutional tax. *Id.* Moreover, a prospective declaration of unconstitutionality does not constitute an ade-

quate remedy.[1] The State must actually erase the property deprivation in order to comply with the Fourteenth Amendment. *Id.* The decision of the Minnesota Supreme Court fails to do so. As in *McKesson*, the State has suggested that in order to redress an unconstitutional deprivation, the State need not actually impose a constitutional tax scheme, but need only place the taxpayer in the same tax position that it would have been placed by a hypothetical scheme. This Court "implicitly rejected this line of reasoning in *Montana National Bank* and *Bennet*, and . . . expressly [did] so [in *McKesson*]. 110 S.Ct. at 2253. The State's duty under the Due Process Clause to provide a clear and certain remedy requires it to ensure that the tax as actually imposed on the taxpayer does not violate federal law and the Supremacy Clause. *Id.* at 2251.

In *McKesson*, this Court recognized that a State could devise a range of remedies to ensure that the tax actually imposed on the taxpayer ~~did~~ not discriminate in violation of the Constitution and could use refunds, retro-

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[1] Nor is the issue in this case one of prospective or retroactive application of a decision as in *American Trucking Associations, Inc. v. Smith*, 110 S.Ct. 2323 (1990). *American Trucking* determined when a *holding* of this Court is to be applied prospectively. *Id.* at 2331. At issue in the instant case is the effective date of the codification of a constitutional principle in 31 U.S.C. Sec. 3124. Any decision regarding the construction of a statute is simply a holding "that the law always meant what the court now says it means. The court has . . . no power by change in construction to date its passage as a law from the time of the later decision." *Fleming v. Fleming*, 264 U.S. 29, 31-32 (1924). As pointed out by this Court in *McKesson*, under the dissent and Justice Scalia's concurrence in *American Trucking*, there is no question of retroactivity and under the position of the plurality, the decision would be retroactive insofar as the decision was "clear under the principles established in [this Court's] previous cases. *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 398 (1983), *McKesson*, 110 S.Ct. at 2247, fn. 15.

active taxation (within limits) or a combination thereof. *Id.* at 2254-2255. This is consistent with this Court's earlier decision in *Montana National Bank* which "held that one forced to pay a discriminatorily high tax in violation of federal law is entitled, *in addition to prospective relief, to a refund of the excess tax paid*—at least unless the disparity is removed in some other manner." *McKesson*, 110 S.Ct. at 2249 (emphasis added).

In the instant case, the State will not, or cannot, remove the tax disparity in any manner other than through a refund of the unconstitutional tax. The State has admitted that it would not remove the discrimination against federal obligations by retroactively assessing tax on the exempt state obligations. *Cambridge, supra*, Appendix p. 10A. And, although this Court recognized retroactive taxation as a means of providing a remedy, it also recognized that there were constitutional restraints in doing so. *McKesson*, 110 S.Ct. at 2252. Certainly, retroactively imposing a tax eleven years later and far beyond the State's statute of limitations cannot be within such constitutional limits. *McKesson*, 110 S.Ct. at 2252, fn. 23. Further, under the circumstances of this case it would be anomalous to correct the unconstitutional discrimination by imposing additional taxes on those who originally suffered the discrimination. That would not be a remedy; it would be a punishment for vindicating one's rights. Thus, the only remedy which will correct the Supremacy Clause violation and which will comport with the Due Process Clause is to require the State to refund the illegally collected taxes.

CONCLUSION

For the reasons set forth above, the Committee on State Taxation of the Council of State Chambers of Commerce respectfully requests that petitioners' petition for writ of certiorari be granted.

Respectfully submitted,

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In The

Supreme Court of the United States

October Term, 1990

NORWEST BANK DULUTH, N.A.,

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v.

MINNESOTA COMMISSIONER OF REVENUE AND THE STATE OF MINNESOTA,

Respondents.

CAMBRIDGE STATE BANK, ET AL.,

Petitioners,

v.

MINNESOTA COMMISSIONER OF REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The Minnesota Supreme Court

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether estopping petitioners who were beneficiaries of state bond exemptions from asserting that the bank tax is discriminatory violates due process.

2. Whether the Minnesota Supreme Court acted inconsistent with *McKesson* by not, as a matter of equity, actually imposing retroactive taxation of state bond interest where the petitioners themselves would have borne the brunt of it and where federal obligation immunity principles would not be furthered by retroactive taxation.

3. Whether the Minnesota Supreme Court's holding that *Memphis Bank* should be applied prospectively only is consistent with opinions of this Court.

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MINNESOTA COMMISSIONER OF REVENUE,

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On Petition For Writ Of Certiorari To The Minnesota Supreme Court

BRIEF IN OPPOSITION

The respondents Minnesota Commissioner of Revenue and State of Minnesota respectfully request that this Court deny the Petition for Writ of Certiorari (hereinafter "Pet.") seeking review of the decision of the Supreme

Court of Minnesota in this case. The opinion of the Minnesota Supreme Court is reported at 457 N.W.2d 716 (Minn. 1990) and is reproduced in the appendix to the Petition at page 1A (hereinafter "Pet. App.").

STATEMENT OF THE CASE

For nearly fifty years Minnesota has had a corporate franchise tax[1] which has included U.S. obligation interest in its net income measure. For a number of years Minnesota exempted from the tax two types[2] of Minnesota state/local bonds – the two whose statutory language appears in Petitioner's Appendix. Pet. App. 52A-53A. The

[1] Petitioners do not dispute the holding of the Minnesota Supreme Court, Pet. App. 4A-6A, that the bank tax is a franchise tax not an income tax.

[2] The retired district court judge who presided over the trial of this case and who signed without modification all proposed findings of fact and conclusions of law presented to him by the petitioner banks found several other types of bonds were exempt from the bank tax. *See* Pet. App. 6A n.4. The Minnesota Supreme Court did not reach the issue of whether these other bonds were exempt since respondents conceded that two types of bonds were exempt, which in itself was enough to present a discrimination issue for the court. *See* Pet. App. 3A n.2. Contrary to the trial court's finding, only two kinds of Minnesota bonds were exempt. Petitioners so concede as reflected by the fact that no other bonds are mentioned in their petition and only two exemptions are presented in their appendix. Pet. App. 52A-53A. The exemption language pertaining to bonds other than those two was in fact not sufficient to exempt them from a franchise tax as opposed to an income tax. Numerous bond counsel opinions to that effect were stipulated to in the case. *See, e.g.*, Resp. App. 5a, ¶6.

first was enacted in 1957 and provided an exemption for revenue bonds issued by the Minnesota State University System for construction of dormitories and other college buildings (SUB bonds). The second exemption was enacted in 1967 for industrial development bonds (IDB bonds).

During the years in which the exemptions were in effect prior to their repeal in 1983 neither petitioners nor any other taxpayer challenged the bank tax on the ground that it was discriminatory against U.S. obligations. Taxes were paid by the banks without objection for all of the 1979-1983 tax years for which they later claimed refunds. There was no requirement applicable to the 1979 and 1980 tax years that taxes be prepaid as a condition of challenging them.[3]

In early 1983 this Court issued its opinion in *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392 (1983). There the Court held that the Tennessee bank tax, which taxed U.S. obligation interest but exempted interest on *all* obligations of the state of Tennessee and *all* of its political subdivisions (over 70 types of bonds), was a discriminatory tax contrary to 31 U.S.C. § 3124(a).

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[3] A prepayment of taxes as a condition of an appeal to the Minnesota Tax Court was effective only for later tax years. *See* Minn. Stat. § 290.531 (1982). In 1989 the prepayment provision (which by then had been recodified as Minn. Stat. § 271.061 (1988)), was repealed. 1989 Minn. Laws c. 324 § 29. Consequently taxes may now be appealed in Minnesota without prepayment.

Even though it believed that Minnesota's bank tax, which exempted only two of the approximately 90 different types of Minnesota bonds,[4] was not unlawful under the rule of *Memphis Bank* the Minnesota Legislature immediately repealed the IDB and SUB exemptions in 1983, thus removing any conceivable discrimination.

Later in 1983 the petitioner banks and nearly all others in the state commenced filing refund claims for bank taxes back as far as 1979, citing the *Memphis Bank* opinion as grounds.

The Minnesota Supreme Court affirmed a trial court finding that the bank tax was discriminatory. The court denied refunds, however, on three separate grounds which, in view of the tortured and unfair description of them contained in the petition, respondents must restate.

The first was that any banks who were owners of exempt state bonds and beneficiaries of the state bond exemptions were estopped from asserting that the Minnesota tax system was discriminatory against U.S. obligations. It was stipulated that the four test banks[5] owned IDB's and benefited from the bank tax exemption. *See* Resp. App. 1a.

Second, the court ruled that any discrimination resulting from a difference in treatment between state and federal bonds should, consistent with this Court's opinion in *McKesson Corp. v. Division of Alcoholic Beverages*

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[4] Interest on all types of Minnesota state and local obligations (approximately 90 in number) other than SUB's and IDB's was not exempt.

[5] *See* Pet. 4 n.1.

and Tobacco, 110 S.Ct. 2238 (1990) (hereinafter "*McKesson*"), be remedied by declaring the state bond exemptions unconstitutional. The Minnesota court did not impose actual retroactive taxation, however, by ordering assessments on state bonds. It said that doing so in a Commerce Clause case like *McKesson* is appropriate because actual retroactive assessments could retroactively equalize the economic impact on competitors affected by the tax, *see* Pet. App. 11A, thereby advancing Commerce Clause objectives. In a federal obligation immunity case, however, the immunity principle is not furthered by actual retroactive assessment because actually undoing any damage done by the state policy is impossible. If the federal government was somehow damaged by Minnesota's tax policy that cannot be undone in this action.

The Minnesota court in the alternative found that it would, if compelled, actually impose a retroactive tax.[6] It did not impose an actual tax because it said actual collection would unfairly penalize the petitioners (who were owners of exempt bonds) for failing to foresee that Minnesota's tax exemptions would become unlawful under *Memphis Bank.*

As a third ground for denying refunds, the Minnesota court found that the *Memphis Bank* case should apply prospectively only. In reaching its conclusion, the Minnesota court, consistent with the recent opinion of this Court in *American Trucking Ass'ns, Inc. v. Smith,* 110 S.Ct.

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[6] Contrary to the statement of petitioners at p. 6 of their petition, respondents never asked the Minnesota court to impose an actual retroactive tax since that tax would have in large part fallen on the petitioners, banks being large holders of IDB's.

2323 (1990) (hereinafter "*ATA*"), applied the prospectivity analysis of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971).

REASONS FOR DENYING THE PETITION

Petitioners never state the ground under Rule 10 on which their petition is premised. Presumably it is under the catch-all provision of Rule 10.1(c) that the decision of the Minnesota Supreme Court conflicts with applicable decisions of this Court.

The petition should be denied because the state court ruling is consistent with decisions of this Court issued in June, 1990 which have defined the law as to remedy issues in cases where state taxes are found to be unconstitutional. These issues have only recently been considered by the Court and the opinions in those cases provide sufficient guidance for the State courts.

The opinion of the Minnesota court is also consistent with the analysis of the Oklahoma Supreme Court in *First of McAlester Corp. v. Oklahoma Tax Comm'n*, 709 P.2d 1026 (Okla. 1985). *First of McAlester* is the only case other than the instant case to consider the *Memphis Bank* prospectivity issue. Since respondents believe there are no other cases pending on the issue in the State courts, they observe that no opinion inconsistent with the instant case and *First of McAlester* is likely.

Petitioners identify no pending *Memphis Bank* cases in which the Court's guidance is needed. They assert instead that the Court should review this case in order to guide courts in deciding remedies in the quite different

context presented by claims of the kind litigated in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989) where this Court found unconstitutional the taxing of retirement benefits of federal employees while exempting state employee retirees. Fashioning appropriate remedies is, however, a case by case analysis given the prospectivity analysis this Court identified in *ATA* and the variety of options open to a state in fashioning a retroactive remedy under the principles of *McKesson*. Consequently, if guidance is needed for *Davis* remedies it should be given in a *Davis* case, not in a *Memphis Bank* case. In fact, a petition for a writ of certiorari in a *Davis* case has been filed in *Bass v. State of South Carolina*, 395 S.E.2d 171 (S.C. 1990), *petition for cert. filed*, No. 90-673 (October 24, 1990).

Even were it otherwise and this were an area of law crying out for clarification by the Court, this case, when candidly presented, provides no occasion for reversal. That petitioners were not awarded tax refunds constitutes no threat to the immunity of federal obligations, petitioners' doomsday scenario to the contrary. The decision of the Minnesota Supreme Court is consistent with the principles of *McKesson* and *ATA*.

I. DENYING REFUNDS TO THESE PETITIONERS DOES NOT UNDERMINE THE IMMUNITY OF U.S. OBLIGATIONS FROM STATE TAXATION.

Petitioners speculate that if refunds can be denied to taxpayers who have paid a tax that infringes on the immunity of U.S. obligations from state taxation, private tax challenges are an endangered species and the immunity of U.S. obligations itself is imperilled. Pet. 10-12. This

argument mistakenly postulates that without the availability of refunds, no actions will be brought to vindicate the principle of federal tax immunity. Petitioners ignore avenues of enforcement that are not dependent on the availability of refunds.

First, petitioners wrongly assume that the only vehicle by which a private party can challenge a tax as unlawful under the federal obligation immunity principle is an action for refund of back taxes. On the contrary, current Minnesota law allows taxpayers to challenge taxes in the Minnesota Tax Court without prepaying taxes.[7] Similarly, petitioners could have challenged without prepayment taxes due for the 1979 and 1980 tax years, which they voluntarily and without objection paid. The vast majority of other states currently permit tax challenges without prepayment.[8] Because nearly all states permit tax challenges without prepayment, a private right of action for a refund of back taxes is not necessary for the effective private enforcement of the immunity principle.

Petitioners also overlook that the U.S. government itself is hardly powerless to challenge taxes violating the

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[7] A prepayment requirement that was in effect for the 1982-1988 period was repealed in 1989. 1989 Minn. Laws c. 324 § 29. *See also supra* note 3.

[8] Respondents believe only two states (Massachusetts and Washington) presently have a prepayment requirement. Respondents believe, moreover, that those states will react to the *McKesson* decision by repealing their prepayment provisions.

immunity principle. It often has commenced suits to declare state taxes unconstitutional.[9]

Petitioners are therefore wrong in their assertion that the Minnesota Supreme Court's denial of refunds "eviscerates private enforcement of immunity doctrine rights." Pet. 17. As important as the federal immunity principle is to all of our collective interests, it is hardly threatened by denying petitioners refunds in this case.

II. ESTOPPING PETITIONERS WHO WERE BENEFICIARIES OF STATE BOND EXEMPTIONS FROM ASSERTING THAT THE BANK TAX WAS DISCRIMINATORY DOES NOT VIOLATE DUE PROCESS.

Petitioners also assert that they were denied due process by the Minnesota Supreme Court's application of an estoppel doctrine to preclude them from asserting that the bank tax was discriminatory. Pet. 12-15. Their argument is based on a gross mischaracterization of the basis for the state court's ruling.

Petitioners characterize the Minnesota court's decision as imposing a "poll tax"[10] on their ability to

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[9] *See, e.g., United States v. County of Fresno*, 429 U.S. 452 (1977) (government challenged tax on government-owned housing used by private citizen); *United States v. New Mexico*, 455 U.S. 720 (1982) (government challenged a sales/use tax on goods and services purchased by private contractors under contracts with U.S. to manage government-owned laboratories).

[10] A "poll tax" is a "capitation tax" or "tax levied upon each person within the jurisdiction of the taxing power and

(Continued on following page)

challenge the bank tax in court, which somehow discriminates against holders of federal obligations. This proposition is based on the unsupported premise that the court estopped petitioners' recovery of refunds because they failed to pay a judicially-imposed tax. Nothing in the Minnesota Supreme Court's opinion suggests that rationale. Instead, the court explicitly held that it was petitioners' enjoyment of the benefit of the challenged exemption that precluded their recovery. Pet. App. 8A.

Minnesota has long recognized an acceptance of benefits doctrine in tax cases, under which a taxpayer is estopped from assuming the validity of a statute for the purpose of receiving its benefits and also attacking it as unconstitutional in an attempt to achieve even greater benefits. *See Gale v. Commissioner of Taxation*, 228 Minn. 345, 37 N.W.2d 711 (1949) (taxpayer who claims a tax reduction as a result of a statutory amendment estopped from challenging the effective date of the amendment). The same doctrine is present in federal cases, as acknowledged by petitioners in their reference to *Kadrmas v. Dickinson Pub. Schools*, 487 U.S. 450, 457 (1988), cited at Pet. 13. *See also Magee v. United States*, 282 U.S. 432 (1931) (taxpayer who benefited from a claim in abatement not in a position to challenge its legality); *Strickland v. Flue-Cured Tobacco Coop. Stabilization Corp.*, 643 F. Supp. 310 (D.S.C. 1986) (rebate beneficiaries of federal tobacco price

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within a certain class (as, all males of a certain age, etc.) without reference to his property or lack of it." Black's Law Dictionary 1043 (5th ed. 1979). A poll tax is not much like the reasoning or the result of the Minnesota court's opinion therefore.

support program barred under doctrine of constitutional estoppel from attacking the statute authorizing rebates).

A very similar doctrine is also often applied in federal tax cases and is known as the "duty of consistency" or "quasi-estoppel" doctrine. Under this doctrine a taxpayer who has received a tax benefit due to treatment of an item in a year barred by the statute of limitations as to an additional assessment is precluded from claiming that the original treatment was incorrect in order to obtain a tax advantage in a later year. *See Unvert v. Commissioner,* 72 T.C. 807 (1979); *Griffith v. Commissioner,* T.C.M. (P-H) ¶ 89,070 at 293 (1989); *Coldiron v. Commissioner,* T.C.M. (P-H) ¶ 87,569 (1987).

Thus the applicability of estoppel doctrines is not a revolutionary idea at either the state or federal level. Moreover, the application of these estoppel principles in appropriate cases was not undermined by this Court's recent decision in *McKesson.* In *McKesson* the Court rejected two "equitable considerations" offered by the state. *McKesson,* 110 S.Ct. at 2254.[11] Neither the acceptance of benefits doctrine nor any similar estoppel doctrine was, however, at issue. Nothing in the *McKesson* case should be seen therefore as overruling such traditional equitable doctrines in tax cases.

The justice in applying an estoppel to these petitioners' claims of discrimination is plain. Petitioners are

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[11] The first was that the State had relied in good faith upon a presumptively valid statute. *McKesson,* 110 S.Ct. at 2255-56. The second was of the nature of a pass on defense, that petitioners would receive a windfall from refunds because they likely passed on the tax to consumers. *Id.*

the type of taxpayer who should be estopped from asserting that a tax is discriminatory. They, for example, benefitted from the state tax exemption of IDB's. All four of the test banks (petitioners) were holders of IDB's. All four reduced their Minnesota bank taxes by claiming the IDB interest as exempt income.[12] They so stipulated. Resp. App. 1a.

Yet, to challenge the Minnesota tax as discriminatory they must assert the exemption was unlawful. They must so assert because Minnesota's bank excise tax is a franchise tax which can lawfully include U.S. obligation income in its measure consistent with 31 U.S.C. § 3124(a). Including U.S. obligation interest in the Minnesota tax did not therefore make Minnesota's tax unlawful. It was the enactment of state bond exemptions that it made it so. This is why the Minnesota court held that:

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[12] Petitioners attempt to direct attention away from this undisputed benefit when they contend the interest they received was lower because of the exemption and that the real beneficiaries of the exemption were the issuers. Pet. 14. This is not an argument raised in either the trial court or the Minnesota Supreme Court and is in any event without merit. Petitioners refer to a general finding by the trial court that the exemption caused interest rates to be lower than they would have been otherwise. Pet. App. 24A. This finding does not quantify the amount by which the state bond exemption might lower the rate or whether it is lowered by such an amount to negate the clear tax benefit derived from the exemption. The record is thus insufficient to support what petitioners contend, which in any event is contrary to common sense since they did indeed invest in IDB's presumably for a tax advantage and not out of a sense of public service because issuers were benefited.

> It is the exemption for interest earned on state obligations that makes the bank tax discriminatory and, therefore, unconstitutional.

Pet. App. 9A. Therefore, petitioners' challenge to the bank tax as discriminatory must properly be viewed as an attack on the exemption for income from state obligations from which they benefited. Accordingly, the argument raised by petitioners, Pet. 13, that the acceptance of benefits doctrine does not somehow apply to them because they challenged not the state exemption but the inclusion of federal obligation income is transparent and was rightly rejected by the Minnesota court.

The Minnesota opinion does not establish some new principle fatal to refund actions concerning unconstitutional taxes in general. It merely applies conventional equity doctrines to these petitioners. While other banks who did not own exempt state obligations may challenge the tax as discriminatory these petitioners may not. The decision below merely restricts litigants like petitioners who want to have their cake and eat it too.

III. THE MINNESOTA SUPREME COURT DID NOT ACT INCONSISTENT WITH *MCKESSON* BY NOT, AS A MATTER OF EQUITY, ACTUALLY IMPOSING RETROACTIVE TAXATION WHERE THE PETITIONERS THEMSELVES WOULD HAVE BORNE THE BRUNT OF IT AND WHERE AN ACTUAL TAX WOULD NOT HAVE FURTHERED THE PRINCIPLES OF FEDERAL OBLIGATION TAX IMMUNITY.

Petitioners attack the opinion of the Minnesota Supreme Court contending that the court, contrary to the principles of *McKesson*, imposed only a fictitious tax as

relief – one which was not to be actually collected. Pet. 15-18. The decision below does not, however, conflict with *McKesson*.

The *McKesson* due process right to retroactive relief does not apply to this case because Minnesota differs from Florida in its requirements for prepaying taxes prior to challenging them. In any event, even if a retroactive tax was imposed, it would accomplish nothing beneficial to the principle of federal obligation tax immunity and petitioners themselves would bear the brunt of any retroactive tax. The instant case is therefore much different than *McKesson* where the retroactive relief would have actually equalized an inequality between competitors thereby advancing Commerce Clause objectives.

A. *McKesson* Is Not Applicable Because Minnesota Provided Predeprivation Relief.

In *McKesson* the Court explained:

> *[I]f a State places a taxpayer under duress promptly to pay a tax when due and relegates him to a post-payment refund action in which he can challenge the tax's legality,* the Due Process Clause of the Fourteenth Amendment obligates the State to provide meaningful backward-looking relief to rectify any unconstitutional deprivation.

McKesson, 110 S.Ct. at 2247 (emphasis added) (footnote omitted). Relief may be either through additional tax assessments against the beneficiaries of the discriminatory tax or through an award of tax refunds to the unfavored taxpayers, or from some combination of the two.

Minnesota law, unlike that of Florida in *McKesson*, for two (1979 and 1980) of the five years as to which *Memphis Bank* claims were filed (1979-1983) allowed an appeal to its Tax Court *without* prepayment. No prepayment requirement was enacted until the 1981 tax year. *See* Minn. Stat. § 290.531 (1982). The 1979 year, which was the "test year" selected by stipulation for litigation of this case,[13] was not a year as to which prepayment was required.

Even as to the 1981-1983 tax years for which a prepayment provision was part of Minnesota law (it has since been repealed), the provision had an escape clause. A taxpayer could avoid prepayment on a showing that the appeal was in good faith, that there was probable cause that the taxpayer would be found exempt from the tax or that the tax ultimately determined might be less than fifty percent of that assessed and that prepayment would work a substantial hardship. Minn. Stat. § 290.531 (1982). *See* Resp. App. 6a.

Minnesota thus did provide for meaningful predeprivation relief and the threshold requirements for retroactive relief of any sort cannot be established by petitioners under *McKesson*.

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[13] *See* Pet. 4 n.1.

B. Even Were *McKesson* Applicable, *McKesson* Should Not Be Read To Prohibit A State From Declining, As A Matter Of Equity, To Impose A Retroactive Tax Where The Taxpayers Challenging The Tax Would Themselves Have Borne The Brunt Of It And Where An Actual Tax Would Not Have Furthered The Principles Of Federal Obligation Tax Immunity.

Petitioners criticize the Minnesota Supreme Court for declaring the state bond exemptions unlawful but then not actually imposing a retroactive tax. Pet. 15-18. Petitioners accuse the Minnesota Supreme Court of imposing a "fictitious retroactive tax." They point out that this Court in *McKesson* rejected an argument advanced by the State of Florida that it need not actually impose a retroactive tax and equalize the tax burden between McKesson and its tax preferred-competitors. Florida instead asserted that McKesson should be placed in the same position it would have been in had such a tax been imposed, which, because Florida would have imposed a higher tax on all rather than extending the preferred treatment to all had it known of the illegality of its preference, would be the higher tax. This Court rejected that hypothetical tax argument because it did not place competitors in the same position they would have been absent a Commerce Clause violation. In that context, and in response to that argument, the Court rejected the argument that back taxes need not actually be collected from the preferred competitors.

The effect of the Minnesota Supreme Court's decision is not to impose a "fictitious tax" in the sense rejected in *McKesson*. Under the remedial options approved in *McKesson* the Minnesota Supreme Court could have

elected to impose retroactive taxes on theretofore tax-exempt state bonds. It chose not to do so out of fairness to these petitioners saying, consistent with its opinion that the *Memphis Bank* opinion established a new principle of law, that "ordering actual collection of the tax in this case would unfairly penalize both parties for failing to see the change in the law brought about in *Memphis Bank*." Pet. App. 11A-12A. In such circumstances, where an actual retroactive tax would have fallen on the very taxpayers asserting the discrimination, banks being heavy owners of state bonds,[14] the court thought it inequitable to impose a retroactive tax.

It was within the court's power to impose a retroactive tax consistent with due process had it opted to do so.[15] To do so, however, makes no sense in this case even

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[14] In 1979, for example, financial institutions owned over 61% of outstanding state and local debt held. Flow of Funds Accounts, Financial Assets and Liabilities, Year-End 1966-1989, Federal Reserve System (Sept. 1990) 44 ("Tax-Exempt Securities and Loans (1)", lines 7-19). Corporate holders are the only holders relevant to the instant lawsuit since state obligations held by individuals are tax exempt in Minnesota.

[15] This Court said in *McKesson* that retroactive assessment of a tax increase does not necessarily deny due process to those whose taxes are increased, though beyond some temporal point the retroactive imposition of a significant tax burden may be "so harsh and oppressive as to transgress the constitutional limitation," depending on "the nature of the tax and the circumstances in which it is laid." 110 S.Ct. at 2252 n. 23 (citations omitted). Surely Minnesota could impose back taxes to tax year 1979. Retroactive taxes have in the past been allowed to reach back into distant tax periods. In *Canisius College v. United States*, 799 F.2d 18, 23-27 (2d Cir. 1986), *cert. denied*, 481 U.S. 1014 (1987), the court allowed a four year retroactive

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though it may in a Commerce Clause case like *McKesson*. The Minnesota court properly distinguished *McKesson* on

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period because the retroactive statute ratified earlier conduct and did not unsettle the expectations of the taxpayer. In *Wilgard Realty Co. v. Commissioner*, 127 F.2d 514, 517 (2d Cir.), *cert. denied*, 317 U.S. 655 (1942) seven year retroactive taxation was approved where the taxpayer would not have acted differently.

Petitioners would have acted no differently in investing in state obligations even if they had been taxable. Petitioners likely based their investment decisions upon the federal tax benefits of investing in state and local obligations which included a *double* tax benefit: 1) an exemption under I.R.C. § 103 from the federal corporate income tax of 20%-22% plus a 26% surtax in 1979 and 2) the even more attractive provisions of I.R.C. § 265 as generously interpreted in favor of banks by the I.R.S. in Rev. Proc. 70-20 to allow deductions for interest expense of producing the exempt income. By comparison, an exemption from Minnesota's franchise tax (12% in 1979) is inconsequential. Petitioners would have invested in the exempt state bonds anyway, so their expectations are not unduly interfered with by retroactive taxation.

Imposition of such a tax would not, moreover, be contrary to the Minnesota statute of limitations in tax cases. Petitioners assert that the statute of limitations (normally three and one-half years) has long since expired on 1979. Pet. 17-18 n.11. They are wrong. The basis for assessing tax on the exempted state bonds did not exist until the Minnesota Supreme Court opinion in the instant case declaring those exemptions to be unlawful. Under Minnesota law the statute of limitations would be equitably tolled until the Minnesota court's 1990 opinion. *See Bartlett v. Miller & Schroeder Muns., Inc.*, 355 N.W.2d 435, 439 (Minn. Ct. App. 1984) (citing *Burnett v. New York Cent. R.R.*, 380 U.S. 424, 428 (1965)). *Cf. Bowmen v. City of New York*, 476 U.S. 467, 479 (1986); *Zipes v. Trans World Airlines, Inc.*, 455 U.S. 385,

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the basis of its Commerce Clause underpinnings. In *McKesson* actually assessing back taxes equalized competitors and remedied the Commerce Clause discrimination in a way meaningful for the preservation of Commerce Clause principles. Actually assessing retroactive taxes in the instant case does not, however, further the principles underlying U.S. obligation immunity. Imposing retroactive taxation does not benefit the United States. As petitioners say, any "detriment to the Federal Government", Pet. 17, is a matter of "historical record and cannot now be undone." *Id.*[16] Nor does actually assessing taxes retroactively benefit petitioners. Taxing petitioners to remedy a defect in Minnesota law which they did not foresee (they filed no refund action challenging these years old exemptions until after *Memphis Bank*) seems pointless.

What was necessary to achieve Commerce Clause objectives in *McKesson* is simply not in order here. Thus, the Minnesota Supreme Court acted properly when it

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398 (1982); *Burnett v. New York Cent. R.R.*, 380 U.S. 424 (1965); *Braun v. Sauerwein*, 77 U.S. (10 Wall.) 218, 223 (1869) (cited in the *ATA* dissent, 110 S.Ct. at 2354 (Stevens, J., dissenting) for the proposition that federal courts historically have asserted equitable discretion to craft rules of tolling, laches, and waiver).

[16] The trial court made no finding as to any actual damage to the Federal Government resulting from the Minnesota exemption. The $1.75 billion figure mentioned at Pet. 5 is hypothetical and is premised on the assumption that all 50 states had a tax system like Minnesota's. The Minnesota Supreme Court said it could not conclude that this hypothetical finding by the trial court was "clearly erroneous." Pet. App. 8A.

distinguished *McKesson* as a case where an actual retroactive tax was necessary to cure economic disadvantages caused by the discriminatory tax. Pet. App. 11A.

McKesson recognized that states ought to have options and flexibility in fashioning a remedy. The Minnesota court has surely exercised its discretion in those respects in a responsible fashion in the instant case.

IV. THE MINNESOTA SUPREME COURT'S HOLDING THAT *MEMPHIS BANK* SHOULD BE APPLIED PROSPECTIVELY ONLY IS CONSISTENT WITH OPINIONS OF THIS COURT AND IS CONSISTENT WITH THE OPINION OF THE ONLY OTHER STATE COURT TO RULE ON THE ISSUE.

Petitioners assert that the third prong of the Minnesota Supreme Court's decision denying petitioners refunds – that the *Memphis Bank* opinion should be applied prospectively only – is in conflict with decisions of this Court. Pet. 18-22. It is not.

The Minnesota court applied the three part analysis[17] of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) and

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[17] *First*, the decision to be applied nonretroactively must establish a *new principle of law*, either by overruling clear past precedent on which litigants may have relied, *or* by deciding an issue of *first impression* whose resolution was *not clearly foreshadowed*. *Second*, it has been stressed that "we must- . . . weigh the merits and demerits in each case by looking to the prior *history* of the rule in question, its *purpose* and *effect*, and whether retrospective operation will further or retard its operation." *Finally*, we

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determined *Memphis Bank* should be prospective only. The Supreme Court of Oklahoma earlier found the same in *First of McAlester Corp. v. Oklahoma Tax Comm'n*, 709 P.2d 1026 (Okla. 1985). The Oklahoma and Minnesota courts are the only courts to have ruled on the issue.[18] It simply involves application of the well-known *Chevron* test to particular circumstances of this case. There is no split among the courts on the issue. There is thus no need to review the prospectivity issue.

A. The *Memphis Bank* Opinion Decided An Issue Of First Impression Whose Resolution Was Not Clearly Foreshadowed.

In *ATA* this Court found that the decision in *American Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266 (1987), which expressly overruled earlier cases, should be applied prospectively. In the *McKesson* case no issue of prospectivity was considered by the Court since the case pertained to

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> have weighed the *inequity* imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

Chevron Oil Co. v. Huson, 404 U.S. at 106-07 (citations omitted) (emphasis added).

[18] No prospectivity issue was present in the *Memphis Bank* case itself because the State of Tennessee had (unwisely) stipulated that if federal interest was excluded no tax was due. *See Memphis Bank*, 459 U.S. at 396.

Apparently, no other state courts have considered the issue. Respondents are aware of no other pending cases on the issue.

taxes paid after the Court's opinion in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) and the law was thus clear without question. In *Ashland Oil, Inc. v. Caryl*, 110 S.Ct. 3202 (1990), this Court held that while *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984), contributed to the development of the Court's Dormant Commerce Clause jurisprudence it was clearly foreshadowed by earlier decisions.[19]

Respondents candidly observe that this case is between the extremes presented by *ATA* (express overrule) and *McKesson* (a state tax which virtually was enacted in blatant disregard of a recent precedent). Like *Ashland* it is somewhere in the middle of the continuum. Unlike *Ashland*, however, there was no clear trend of recent decisions of this Court which clearly foreshadowed *Memphis Bank*.

Memphis Bank came as a surprise to both states and taxpayers. While petitioners argue that the Minnesota court's prospectivity holding is a "pretext designed to cover the court's blatant disregard for federal constitutional rights," Pet. 21, they seem to forget to ask themselves why, if the particular federal right at issue in this case was clearly established prior to the 1983 *Memphis Bank* opinion, did not one of Minnesota's approximately 700 banks – the most sophisticated of taxpayers – challenge Minnesota's tax until after *Memphis Bank*. Surely petitioners cannot claim they were ignorant of the exemptions – they directly benefited from the IDB exemption.

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[19] The Court in *Ashland* referred to its 1981 opinion in *Maryland v. Louisiana*, 451 U.S. 725 (1981) and its 1977 opinion in *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318 (1977) as foreshadowing the *Armco* decision.

Petitioners make much of language in the Court's *Memphis Bank* opinion that the Court had "frequently considered" the discrimination issue and that its decision was "clear" under principles of earlier cases. Pet. 20. The petitioners fail to observe, however, that this Court also noted that the *Memphis Bank* case presented the first occasion to determine whether a tax was discriminatory since the 1959 enactment of 31 U.S.C. § 3124 (then § 742). *Memphis Bank*, 459 U.S. at 396. And with all due respect to the Court's statement that the nondiscrimination rule had been frequently considered, none of the decisions which the Court identified as framing the constitutional rule which the statute embodies involve fact situations very similar to that presented in *Memphis Bank*. And, it must be recalled, tax law is a highly conceptual area of the law where seemingly minor differences in form or structure portend major differences in result.

The states found themselves in an embarrassing position after the *Memphis Bank* opinion because they had had state bond exemptions in their tax systems for years. Respondents believe that the states enacted their franchise tax systems exempting state/local bonds but taxing federal bonds in reliance on language in the opinion in *Miller v. City of Milwaukee*, 272 U.S. 713 (1927). Language in *Miller* suggested that unless a state tax policy amounted to an intentional interference with or evasion of federal obligation immunity principles it was not unlawful. In *Miller* the Court held unlawful a Wisconsin corporate income tax (not a franchise tax) provision which taxed shareholders on dividends received which applied only when the corporation paying the dividend earned exempt (U.S. obligation) income. The Court found

this to be an "intentional interference" with and an evasion of U.S. obligation immunity principles.

In the *Miller* opinion, however, the Court said:

> *If the avowed purpose or self-evident operation of a statute is to follow the bonds of the United States* and to make up for its inability to reach them directly by indirectly achieving the same result, the statute must fail. . . . We think it would be going too far to say that they [(the Acts of Congress)] allow *intentional interference* that is only prevented from being direct by the artificial distinction between a corporation and its members. *A tax very well may be upheld as against any casual effect it may have upon the bonds of the United States when passed with a different intent and not aimed at them, but it becomes a more serious attack on their immunity when they are its obvious aim.*

272 U.S. at 715 (emphasis added). Respondents believe that state practices of exempting local bonds while taxing U.S. obligations under their franchise taxes took root in this statement. Exempting local bonds, at an actual revenue cost to the state, with a motive of furthering the public policy purpose of that type of bond and without any devious motive to improperly tax U.S. bonds, would seem to pass muster under such a standard.

While petitioners suggest that there exists a veritable plethora of precedents of this Court which could be said to portend *Memphis Bank*, they mention only *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935). Respondents agree that *Schuylkill* is the only decision of the Court which even arguably foreshadowed *Memphis Bank*.

In the 1935 *Schuylkill* opinion, this Court considered not a franchise tax measured by income but rather a

property tax on bank shares. The Court held that excluding from the computation of net taxable assets securities issued by certain Pennsylvania corporations, while including U.S. obligations in the computation, discriminated against the Federal Government. The analysis in *Schuylkill* is murky because in large part it dealt with the question of whether the incidence of the tax was on stock shares, as such, or on the banks assets which included government securities. 296 U.S. at 119. The opinion therefore did not establish any clear general rule and could well have been thought to be of narrow application and confined to the peculiarities of the tax at issue. The majority opinion said nothing inconsistent with the language in *Miller* and the dissent mentioned the *Miller* unfriendly discrimination standard discussed above, *id.* at 127 (Cardozo, J., dissenting).

Respondents do not quarrel with the Court's decision in *Memphis Bank*, but ask the Court to recognize that this is an area of little precedent and one in which states assumed a legal standard (that of *Miller*) for many years. The tax practices they established were not challenged for many years. Respondents submit that in such circumstances it cannot be said that *Memphis Bank* was clearly foreshadowed.

Petitioners make much of the 1939 opinion of the Minnesota Supreme Court in *State v. Duluth, M. & N. Ry.*, 207 Minn. 618, 292 N.W. 401 (1939), *reh'g. denied*, 207 Minn. 637, 292 N.W. 411 (1940), *cert. denied*, 311 U.S. 719 (1941). This opinion, as petitioners observe, was not addressed by the Minnesota Supreme Court in its decision in the instant case. Petitioners do not similarly observe that the trial court which decided every issue in

petitioners' favor, did not mention it in its order on Phase I (liability) of the case and thus did not regard it as relevant either.[20]

The actual holding of the Minnesota Supreme Court in *Duluth Ry.* was based on its construction of a statute, not the Constitution. 1933 Minn. Laws, c. 405, § 12(g) provided for the following statutory exemption from gross income:

> (g) Income received from the United States, its possessions, its agencies, or its instrumentalities, so far as immune from state taxation under federal law.

The court said of this statutory exemption:

> *Subsection (g)* by expressly exempting income from federal securities so far as immune from state taxation under federal law, in effect, *provides that such income shall not be included in the measure of the franchise tax. Although a state may constitutionally impose a franchise tax measured by income,* including income from tax-exempt securities, . . . *subsection (g) provides that such income shall not be included as a measure of the tax on the franchise.*

207 Minn. at 626, 292 N.W. at 406 (citations omitted) (emphasis added). The court thus interpreted subsection (g) as an indication of the legislature's intent that no federal interest should be included in the measure of the

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[20] The opinion was referred to only as an afterthought in the trial court's Phase II order (remedy). Pet. App. 40A-41A.

corporate tax. This determination of legislative intent did not foreshadow a ruling on federal constitutional law.[21]

Surely the Minnesota and Oklahoma Supreme Courts were correct in applying the *Chevron* analysis and concluding that *Memphis Bank* was not clearly foreshadowed.

B. Retroactive Application Will Not Advance The Operation Of The Principle Of Federal Obligation Tax Immunity.

The second *Chevron* criterion[22] also weighs in favor of the Minnesota Supreme Court's decision. The objective of the federal tax immunity principle is to protect the investment attractiveness of U.S. obligations. This objective will not be advanced by retroactive application of the *Memphis*

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[21] Even such dicta as appears in the opinion subsequent to the court's rendering of its holding on statutory grounds does not clearly foreshadow a holding of the United States Supreme Court to be rendered 44 years later. No dicta in such an obscure case should be regarded as foreshadowing anything. The case was indexed by West Publishing under a railroad taxation key number. Likely as a consequence, it has not been cited on the United States obligation interest issue in any subsequent opinion. Despite numerous refund claims having been filed with the Commissioner on the basis of *Memphis Bank*, no one even discovered the *Duluth Ry.* case until early November 1986 when the instant case was on the eve of trial. Petitioners will observe that it was contained in an annotation in Minnesota Statutes Annotated. This apparently did not, however, assist anyone in finding it. By reason of its very obscurity, the dicta in *Duluth Ry.* cannot be said to clearly foreshadow *Memphis Bank.*

[22] *See supra* note 17.

Bank opinion. Retrospective application and refunds for petitioners would not further the purpose of the tax immunity rule because investment decisions were made before the decision. Paying banks refunds today will not retroactively make federal obligations more attractive.

Nor is it necessary to punish states as a deterrence measure. Just as Oklahoma did, Minnesota promptly responded by removing any discriminatory aspect of its tax[23] shortly after the *Memphis Bank* decision and before any refund claims challenging the tax were filed. No threat of punishment was necessary to induce Minnesota to correct its system. Should some state not act in good faith in the future, that can be given consideration by the Court as an equity against the state, as it clearly was in *McKesson*.

Punishment is not appropriate for its own sake nor is it necessary to give taxpayers incentives to challenge unlawful tax systems. *See supra* Argument section I.

The goal of the federal policy not being furthered by retrospective application, this second factor of the *Chevron* prospectivity analysis strongly leans in favor of prospective application.

C. Retroactive Application Of *Memphis Bank* Would Produce A Substantially Inequitable Result.

The equities[24] surely weigh heavily against petitioners. These include the following: 1) petitioners

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[23] *See* 1983 Minn. Laws c. 213.

[24] *See supra* note 17.

themselves benefited from state bond exemptions which made the tax discriminatory, 2) because petitioners are heavy holders of U.S. obligations, refunds would minimize or eliminate their tax liability allowing them to freeload on other taxpayers for the cost of government, and 3) refunds confer a windfall on petitioners since they never had any expectation other than that U.S. obligations would be included in the Minnesota tax.

D. The Dissenters In *ATA* Should Agree With The Decision Of The Minnesota Supreme Court.

There is plainly a philosophical difference of opinion on the Court as to whether civil cases should be applied prospectively only. However that issue ultimately resolves itself, it should not alter the outcome in this case.

Even if retroactivity principles are regarded as "remedial principle[s] for the exercise of equitable discretion by federal courts," *ATA*, 110 S.Ct. at 2353 (Stevens, J., dissenting), as opposed to choice of law principles, equitable principles surely weigh in favor of the result reached by the Minnesota Supreme Court.

The fundamental equity in respondents' favor in this case is premised upon an examination of whose expectations were violated by the *Memphis Bank* opinion. The decision was a surprise to all involved – to both the states, who had for years included federal interest in their franchise taxes while exempting state obligations, and to taxpayers such as petitioners, who paid the tax for years without objection and filed refund claims only after the 1983 *Memphis Bank* decision. The states expected that their taxes were lawful and relied on that expectation in

collecting and spending revenue. The petitioners did not prior to 1983 have any expectation that federal obligation interest would not be taxed. They did not, for example, buy federal obligations on the assumption that they would not be taxed only to have that assumption later violated. Clearly, all of the reliance interests in the analysis favor respondents.

However the philosophical division on the Court on the prospectivity/retroactivity issue be resolved, this case should still be decided in respondents' favor.

CONCLUSION

For the foregoing reasons the petition should be denied.

Respectfully submitted,

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Phase I Stipulation of Facts ¶7:

In all tax years in issue, Norwest Bank Duluth, Cambridge State Bank, Midway Bank St. Paul, and First Security State Bank Sleepy Eye have received interest income on industrial development bonds ("IDB's") pursuant to Chapter 474 of Minnesota Statutes and pursuant to Minn. Stat. § 474.12, subd. 1 (repealed 1983, Minn. Laws, c. 213) did not include in the measure of their taxable net income under Minn. Stat. § 290.361 any interest received on IDBs issued prior to July 1, 1979.

Phase I Stipulation of Facts, Ex. M-9:

FAEGRE & BENSON

1300 NORTHWESTERN BANK BUILDING

MINNEAPOLIS, MINNESOTA 55402

612/371-5300

$2,360,000 Minnesota Higher Education Facilities Authority Mortgage Revenue Bonds, Series W (Bethel College)

We hereby certify that we have examined certified copies of proceedings taken preliminary to and in the issuance by the Minnesota Higher Education Facilities Authority (the "Authority"), of its negotiable coupon, registrable First Mortgage Revenue Bonds, Series W (Bethel College) in the aggregate principal amount of $2,360,000, dated August 1, 1978, consisting of 472 bonds numbered 1 to 472 in the denomination of $5,000 each, maturing on April 1 in years and amounts as follows:

$ 10,000 in 1979,
$ 50,000 in 1980 to 1985,
$ 75,000 in 1986 to 1990,
$100,000 in 1991 to 1994,
$125,000 in 1995 to 1997,
$150,000 in 1998 to 2000, and
$450,000 in 2001, all years inclusive,

All bonds maturing on or after April 1, 1995 being subject to redemption in inverse numerical order at the option of the Authority on April 1, 1994 and any interest payment date thereafter at par plus accrued interest, all bonds also being subject to redemption at par plus accrued interest in whole in certain events of damage to or condemnation of the Project and change of law or circumstances and in certain cases of interest on the bonds becoming subject to

federal income taxation as provided in the Indenture and Lease, and bearing interest at the rates per annum according to years of maturity as follows:

1979	to 1991	maturities at 7.00%,
1992		maturities at 6.90%,
1993		maturities at 6.40%,
1994		maturities at 6.50%,
1995		maturities at 6.60%,
1996		maturities at 6.70%,
1997		maturities at 6.75%,
1998		maturities at 6.80%,
1999		maturities at 6.90%, and
2000	to 2001	maturities at 7.00%, all years inclusive,

interest payable April 1, 1979 and semiannually thereafter on October 1 and April 1 in each year, both principal and interest payable at the Northwestern National Bank of Minneapolis, in Minneapolis, Minnesota (the "Trustee"), issued for the purpose of financing the cost of constructing two housing residences with appurtenant furnishings and equipment and site improvements (the "Project") at Bethel College (the "College"), in Arden Hills, Minnesota; and have also examined executed copies of the Agreement dated as of May 23, 1978, between the Authority and the Baptist General Conference (the "Conference"), an Illinois non-profit corporation, as owner and operator of the College (the "Agreement"), the deed of the Project site from the Conference to the Authority (the "Deed"), the Lease dated as of July 1, 1978 between the Authority and the Conference (the "Lease"), the Mortgage Trust

Indenture dated as of July 1, 1978 between the Authority and the Trustee (the "Indenture"), and the Guaranty Agreement dated as of July 1, 1978 between the Conference and the Trustee (the "Guaranty") referred to in the Bonds, together with a mortgagee's title policy issued by Chicago Title Insurance Company, one of the executed Bonds (No. 1) and such other documents as we deemed necessary for the purpose of the following opinion.

From such examination, it is our opinion that:

1. The Authority is an agency of the State of Minnesota with authority under Sections 136A.25 to 136A.42, Minnesota Statutes, to issue the Bonds, to acquire and lease to the Conference, acting for and on behalf of the College, the Project and to execute and deliver the Indenture to secure the Bonds.

2. The Bonds, the Deed, the Agreement, the Lease, the Indenture and the Guaranty have been duly authorized by all necessary proceedings and duly executed and delivered.

3. The Bonds, the Lease, the Indenture and the Guaranty are valid and binding instruments enforceable in accordance with their terms, subject to bankruptcy and similar laws affecting the enforcement of creditors' rights generally.

4. The Indenture provides a valid and direct first mortgage lien on the Project and the site thereof subject only to the Lease and encumbrances permitted by the Indenture.

5. The Bonds are further secured by the General Bond Reserve Account established by the Authority by its

General Bond Resolution dated October 31, 1972, on a parity with bonds of other series as provided in the General Bond Resolution.

6. The interest on the Bonds is exempt from federal and Minnesota state income taxation (other than Minnesota corporate franchise taxes measured by income) under present laws and rulings.

7. The Bonds are exempt from registration under the Securities Act of 1933 and Minnesota Statutes, Chapter 80A, and the Indenture is exempt from qualification under the Trust Indenture Act of 1939.

Dated at Minneapolis, Minnesota, August 7, 1978.

Minn. Stat. § 290.531 (1982):

When a taxpayer appeals his tax liability under this chapter to the tax court, and the amount in dispute is more than $4,000, the entire amount of the tax shall be paid at the time it is due unless permission to continue prosecution of the petition without payment is obtained as provided herein. The petitioner, upon ten days notice to the commissioner, may apply to the court for permission to continue prosecution of the petition without payment; and, if it is made to appear

(1) That the proposed review is to be taken in good faith;

(2) That there is probable cause to believe that the taxpayer may be held exempt from the tax or that the tax may be determined to be less than 50 percent of the amount due; and

(3) That it would work a substantial hardship upon petitioner to pay the tax, the court may permit the petitioner to continue prosecution of the petition without payment, or may fix a lesser amount to be paid as a condition of continuing the prosecution of the petition.

Failure to make payment of the amount required when due shall operate automatically to dismiss the petition and all proceedings thereunder unless the payment is waived by an order of the court permitting the petitioner to continue prosecution of the petition without payment.

(4)

No. 90-645

Supreme Court, U.S.
FILED
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JOSEPH F. SPANIOL, JR.
CLERK

In The

Supreme Court of the United States

October Term, 1990

Norwest Bank Duluth, N.A.,
Petitioner,

v.

Minnesota Commissioner of Revenue
and the State of Minnesota,
Respondents.

Cambridge State Bank, et al.,
Petitioners,

v.

Minnesota Commissioner of Revenue,
Respondent.

On Petition for Writ of Certiorari to the Minnesota Supreme Court

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PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

The Petitioners respectfully submit this Reply Brief in response to the Brief in Opposition filed by Respondents.[1]

I. The Petitioners Did Not Have a Prepayment Remedy.

Respondents allege that *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S. Ct. 2238 (1990), which involved a Florida tax, can be distinguished from the instant case because "Minnesota differs from Florida in its requirements for prepaying taxes prior to challenging them . . . Minnesota law, unlike that of Florida in *McKesson*, . . . allowed an appeal to its Tax Court *without* prepayment." (Resp. Br. 14-15.) However, as discussed below, the Tax Court prepayment option was not in fact available to Petitioners. Petitioners followed the only route then available in Minnesota for challenging the bank excise tax: payment of the tax followed by a refund suit in Minnesota district court.

Although Respondents are correct in stating that a taxpayer could have filed a petition in the Minnesota Tax Court without prepayment prior to (but not after) February 1, 1982, they fail to point out that the Tax Court would not have had jurisdiction to consider Petitioners' constitutional challenge to the Minnesota bank excise tax. The tax year here at issue is 1979. Petitioners filed 1979 tax returns in 1980, which would have been the earliest opportunity for them to challenge the bank excise tax imposed for

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[1] Reference is made to the Rule 29.1 Statement of Petitioners included in their petition for certiorari. The statement remains accurate without amendment.

1979. The Minnesota Supreme Court in 1980 decided a pair of cases, *Matter of McCannel*, 301 N.W.2d 910 (Minn. 1980) and *Guilliams v. Comm'r*, 299 N.W.2d 138 (Minn. 1980), in which the court held that the Tax Court had no jurisdiction to decide constitutional issues in cases filed initially with the Tax Court. The court held further that the Tax Court's jurisdiction over constitutional issues extended *only* to cases transferred to the Tax Court by a district court. *McCannel*, 301 N.W.2d at 919-20; *Guilliams*, 299 N.W.2d at 139, n. 1.[2]

Thus, Petitioners could not have initiated their constitutional challenge to the bank excise tax in the Minnesota Tax Court. They were required to commence suit in a Minnesota district court, and the rules applicable to district court litigation required payment of the tax. Jurisdiction over tax cases was conferred on the district courts by Minn. Stat. § 290.50, which authorized refund actions (not prepayment actions) to recover taxes paid "in excess of the amount legally due." (Pet. App. 50A.) Petitioners fully complied with Minn. Stat. § 290.50 by paying the tax here at issue, timely filing refund claims and timely commencing suit. (Pet. App. 20A.) Petitioners did not have a prepayment option and *McKesson* cannot

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[2] The Minnesota Supreme Court had raised the issue of the Tax Court's constitutional jurisdiction in an earlier case, *Harris v. Comm'r*, 257 N.W.2d 568, 569, n. 1 (Minn. 1977), but declined to rule on it because the issue had not been raised by the parties. Thus, any taxpayer bringing a constitutional challenge in the Tax Court after 1977 would have done so at considerable jurisdictional risk. In fact, even prior to 1977, constitutional questions had long been brought in the Minnesota district courts rather than the Minnesota Tax Court. *See* Johnson, *Administrative Procedures in the Minnesota Department of Taxation*, 41 Minn. L. Rev. 435, 443 (1957) ("problems of statutory interpretation are generally heard on appeal before the Board of Tax Appeals [i.e., the Tax Court], whereas constitutional questions are usually litigated in the district court.")

be distinguished on that basis.[3]

Petitioners also question Respondents' unsupported assertion that "nearly all states currently permit tax challenges without prepayment." (Resp. Br. 8.) Respondents' "belief" that only Massachusetts and Washington have a prepayment rule is obviously mistaken, since the tax required to be paid prior to challenge in *McKesson* was imposed by the State of Florida. Similarly, the taxpayers in *American Trucking Associations, Inc. v. Smith*, 110 S.Ct. 2323 (1990), had no prepayment option in Arkansas. The taxpayers were forced to obtain an escrow order from this Court because Arkansas insisted on continuing to collect the unconstitutional tax. *American Trucking Associations, Inc. v. Gray*, 483 U.S. 1306 (1987). Indeed, three out of the four states bordering Minnesota require payment of taxes before a challenge can be raised.[4] Petitioners believe that most states *do* require prepayment

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[3] Even if Petitioners could have challenged the bank excise tax in Tax Court, nothing in *McKesson* holds that a taxpayer must seek prepayment relief where the state provides a statutory refund procedure. The Minnesota Supreme Court, in upholding the constitutionality of the Tax Court, observed that "it is crucial to note that the taxpayer always has the option to file in district court," and that "this is perhaps the saving feature of the statutory scheme." *Wulff v. Tax Court of Appeals*, 288 N.W.2d 221, 225 (Minn. 1979). Petitioners clearly would be deprived of due process of law if it were held that they could be denied refunds for having failed to litigate in Tax Court, notwithstanding their full compliance with state refund procedures. *See Brinkerhoff-Faris Trust & Savings Co. v. Hill*, 281 U.S. 673 (1930).

[4] *See Hennick v. Wisconsin Dept. of Revenue*, No. 88-I-433 (Wisc. Tax App. Comm. Oct. 12, 1989) (1989 Wisc. Tax Lexis 36) (taxpayer subject to 25% incorrect return penalty for raising "good faith" constitutional claim by not paying tax; taxpayer should have paid tax and sued for a refund); Iowa Code § 421.8A (Iowa taxpayers must pay tax, penalty and interest or post bond prior to contesting disputed assessment); S.D. Codified Laws Ann. § 10-59-20 (South Dakota taxpayers required to pay taxes and seek refund).

of unconstitutional taxes, and for that reason the Minnesota Supreme Court's decision denying refunds is a very real threat to the enforcement of intergovernmental immunity doctrine rights.

II. The Decision of the Minnesota Supreme Court Conflicts with the Ninth Circuit's Decision in *U.S. v. City of Spokane.*

Respondents observe that Petitioners' request for certiorari is based on Rule 10.1(c) because the decision of the Minnesota Supreme Court conflicts with decisions of the United States Supreme Court. (Resp. Br. 6.) This is correct. However, since the filing of the petition, grounds for review have also arisen under Rule 10.1(b) because the decision of the Minnesota Supreme Court also conflicts with the recent decision of the Ninth Circuit in *U.S. v. City of Spokane*, No. 90-35118 (9th Cir. Oct. 31, 1990) (1990 U.S. App. Lexis 19119).

At issue in *City of Spokane* was whether a city could impose a gambling tax against the Inland Northwest Chapter of the American Red Cross ("INC").[5] The Ninth Circuit held that, because INC was a federal instrumentality, the tax violated the

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[5] The action was brought by the Federal Government on behalf of itself and INC. Respondents suggest that the Federal Government could likewise bring actions to prevent discriminatory taxation under 31 U.S.C. § 3124(a) (the current codification of 31 U.S.C. § 742), and that Petitioners have thus overstated the threat posed by the instant case to enforcement of that statute. (Resp. Br. 8-9.) However, while it is possible that the Federal Government could sue to enforce the statute, a review of numerous annotations under 31 U.S.C.A. § 3124(a) discloses not a single case in which the Federal Government has done so. The statute has been enforced through private actions exclusively.

doctrine of intergovernmental tax immunity. After refusing to apply its ruling prospectively only,[6] the Ninth Circuit considered the question of refunds.

INC sought to recover taxes for a six-year period that it had paid without protest. Washington, like Minnesota, permits refunds of taxes paid even though no protest is made at the time of payment. The Ninth Circuit held as follows:

> That the INC is entitled to relief can hardly be questioned. It is true that the exact form of relief is often left to the local governmental entity when a tax is struck down as unconstitutional. However, that is typically done in cases where there is a commerce clause violation which can be remedied in any one of a number of ways. *See, e.g., Ashland Oil, 110 S.Ct. at 3205; American Trucking, 110 S.Ct. at 2330; McKesson Corp., 110 S.Ct. at 2252.* That approach has no application here, for here, purely and simply, a tax has been exacted from a federal instrumentality. The only logical relief, aside from precluding further taxation, is to order the improperly taken monies refunded.

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[6] The Ninth Circuit refused to apply its ruling prospectively only because no new principle of law was established. The court also noted that "retroactive operation . . . [would encourage] local entities to tread carefully when they impose taxes on entities like the Red Cross," and that the equities favored INC because, although it had spent the tax revenues, the city "should have entertained the gravest doubts about its right to collect the tax." While the Ninth's Circuit's prospectivity ruling is not directly on point here, Petitioners note that the court's analysis is very similar to that urged by Petitioner's and adopted by the trial court in this case.

This holding of the Ninth Circuit is flatly in conflict with the Minnesota Supreme Court's decision in the instant case. The Minnesota Supreme Court distinguished *McKesson* as a Commerce Clause case and held that it did not have to order refunds because the proper remedy was to impose a fictional retroactive tax on state obligations. (Pet. App. 11A.) This, of course, is no remedy at all. The Ninth Circuit also recognized a distinction between Commerce Clause and intergovernmental immunity cases, but reached the opposite conclusion: A tax that violates the intergovernmental immunity doctrine must be refunded.

This Court in *McKesson* held that when a tax is "beyond the State's power to impose," then the state has "no choice but to 'undo' the unlawful deprivation by refunding the tax . . ." 110 S.Ct. at 2251. The Ninth Circuit's decision ordering refunds is consistent with *McKesson*; the decision of the Minnesota Supreme Court is not. Petitioners accordingly ask that the Court grant certiorari to resolve the conflict, and that the decision of the Minnesota Supreme Court be reversed.

III. Conclusion

For the reasons set forth above and in the petition for certiorari, Petitioners request that their petition for certiorari be granted.

Respectfully submitted,

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